S. HRG. 109–638

MANAGING RETIREMENT ASSETS: ENSURING SENIORS DON'T OUTLIVE THEIR SAVINGS

HEARING

BEFORE THE

SPECIAL COMMITTEE ON AGING
UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

WASHINGTON, DC

JUNE 21, 2006

Serial No. 109–25

Printed for the use of the Special Committee on Aging

U.S. GOVERNMENT PRINTING OFFICE

30–042 PDF WASHINGTON : 2006

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

CONTENTS

MANAGING RETIREMENT ASSETS: ENSURING SENIORS DON'T OUTLIVE THEIR SAVINGS

WEDNESDAY, JUNE 21, 2006

U.S. SENATE,
SPECIAL COMMITTEE ON AGING,
Washington, DC.

The Committee met, pursuant to notice, at 10:07 a.m., in room SD–106, Dirksen Senate Office Building, Hon. Gordon H. Smith (chairman of the committee) presiding.

Present: Senators Smith, Martinez, Kohl, Carper, and Salazar.

OPENING STATEMENT OF SENATOR GORDON H. SMITH, CHAIRMAN

The CHAIRMAN. Good morning, ladies and gentlemen. We thank you all for coming to this important hearing. We thank our witnesses who have joined us. I will introduce them after our brief opening statements.

A lot of attention has been focused lately on the need for Americans to increase their retirement savings. This attention is very important and extremely warranted in light of our Nation's low savings rate. However, today's hearing will address the equally important next step of managing assets and preserving your savings throughout retirement.

With a huge wave of baby-boomers about to enter retirement, it is more important than ever that we educate Americans about the financial risks in retirement. Individuals face a variety of challenges in managing their assets during retirement. Americans are living longer than ever. Therefore, we need to stretch our retirement dollars over a longer period of time than in the past.

Retirees also should be concerned that inflation could erode their purchasing power, and their investments may yield less returns than expected or decline in value. Large, unplanned expenses such as those to cover health care or long-term care also may occur at some point during retirement.

Furthermore, unless the tide turns, more and more individuals will enter retirement with an inadequate nest egg. The personal savings rate in the U.S. has declined dramatically over the last two decades, reaching minus 1.6 percent in April. This is the 11th consecutive month that the savings rate has been negative. Clearly, it will be very difficult to be financially secure if you begin retirement with insufficient savings.

I am currently developing legislation with Senators Conrad and Kerry that addresses many of these issues. Although the bill will help all Americans, its focus is on the retirement security specifi-

cally of women. This is because women face greater financial risks than men in retirement. Women tend to live longer and women receive significantly less income during retirement than men.

My bill will increase American's retirement savings. That is its point and its purpose. It also will provide tax incentives for lifetime payments to help seniors protect against the risk of exhausting their retirement income. Since one of the keys to effective management of retirement assets is knowledge, this bill also will improve America's financial literacy.

I would like to thank our witnesses for joining us this morning. I am eagerly anticipating the testimony that each of you will share and look forward to a productive dialog on how to best manage assets during retirement.

With that, I turn to my ranking member, my friend and colleague, Senator Kohl of Wisconsin, for his opening remarks.

OPENING STATEMENT OF SENATOR HERB KOHL

Senator KOHL. We thank you, Mr. Chairman, and good morning to all who are here today. We thank our witnesses for appearing today to discuss how we can ensure that seniors do not outlive their savings.

Of course, managing savings after retirement is an issue only if seniors have been able to save for retirement. Most workers don't save enough to have the sorts of choices that we will discuss today. So we must also focus on helping workers save for retirement, as well as helping them manage the savings that they have managed to put together.

For retirees with nest eggs, we must encourage them to strike a balance between annuities, which protect them from running out of money in retirement, and assets that preserve flexibility for unexpected expenses like costly long-term care. We need also to guard against scam artists who con retirees into buying unsuitable annuities.

The largest source of annuities in the United States, of course, is Social Security, which pays monthly benefits for life. Unlike most defined benefit plans and private annuities, Social Security payments also automatically increase with inflation, which protects the purchasing power of retirees. So as we discuss private sector annuities today, we must remember that the most powerful action we can take to help most seniors post-retirement is to make sure that Social Security remains healthy and whole.

For those who are able to supplement Social Security with a private sector annuity, employer plans offer a product at a lower cost than is available to an individual. Unfortunately, only 30 percent of defined contribution plans offer an annuity as a pay-out option. To boost this number, I am examining the merits of requiring defined contribution plans to offer an annuity as a pay-out option, just like defined benefit plans are required to do. Another possible approach is to offer incentives for plans to voluntarily offer an annuity.

We need to help people understand how annuities work and what their benefits are. One way to educate the public on annuities is through hearings just like this one, and so I look forward to the

testimony of our witnesses. We appreciate your attendance here today.

Again, I thank you, Mr. Chairman, for holding this hearing.

The CHAIRMAN. Thank you, Senator Kohl.

We will next turn to Senator Salazar, of Colorado, and then Senator Martinez, of Florida.

OPENING STATEMENT OF SENATOR KEN SALAZAR

Senator SALAZAR. Thank you very much, Chairman Smith and Ranking Member Kohl, for assembling this important panel of experts to deal with this important issue. I hope to learn a lot from all of you today because this is an important issue for all of our country. It is important as an issue for me in Colorado, with nearly half a million individuals who are now over the age of 65.

As our country continues to grapple with the graying, and may I say balding of America—that is for me and Herb, Senator Kohl—I believe must continually examine this issue, taking proactive and thoughtful steps to encourage American workers to plan for their retirement. Education is a critical component in that planning, and unfortunately we don't have enough education in this country on financial planning for retirement.

Research has shown that when individuals are provided financial education, they are better able to make smart choices on how much money to save and how to wisely invest their money. With advances in medicine, people are living longer than they ever have before. So good and wise planning is even more important.

I am pleased that we will be hearing from companies like MetLife and Vanguard who are in the business of asset management and can share their ideas on how to help seniors plan for their future. In addition, I am interested in hearing from the AARP, who I worked with over the years on many issues impacting Colorado seniors. Whether it is choosing a Medicare Part B plan or deciding whether to take a lump-sum payment or to establish an annuity, seniors in my State most often turn to AARP for guidance. Finally, I am very interested to hear from Ben Stein, who uses his intelligence and his wit to call attention to many issues, including financial management and retirement security.

Again, Mr. Chairman and Ranking Member, I thank you for holding this important hearing.

The CHAIRMAN. Thank you, Senator Salazar.

Senator Martinez.

OPENING STATEMENT OF SENATOR ROBERT MARTINEZ

Senator MARTINEZ. Good morning, Mr. Chairman, and thank you for holding this hearing. You and Senator Kohl are to be commended for pointing out this very important issue.

I would like to have my full statement in the record, if that would be all right, and just highlight a couple of issues that strike me as being particularly important for us to consider as part of your call.

The CHAIRMAN. Without objection.

Senator MARTINEZ. Obviously, when more than 52 percent of Americans say that they are worried about their retirement, it is obvious that some things are of concern which are rooted in the

fact that nearly a third of Americans have saved nothing for retirement last year and that one out of four Americans in their peak earning years saved nothing for retirement in the last year. So educating people about the need for planning and that sort of thing is very important.

In addition to that, last year was the first full year since the Depression that Americans spent more than they earned, and that obviously adds to a negative savings rate for Americans. We need to ask ourselves would we save more if the Federal Government streamlined the current abundance of tax breaks for saving. A report by the President's Advisory Panel on Federal Tax Reform suggests boiling all the current retirement plans into three simpler ones, all of which would be allowed to grow tax-free.

It is also important that regardless of what planning may go on for retirement, the cost of health care is also a tremendous burden on seniors. The cost of health care can be a jolt for early retirees whose employers' coverage ends and all of a sudden they find themselves having to self-provide for their insurance, either self-employed or not employed, prior to the kicking-in of their Medicare benefits. So for young retirees, that is also a problem.

We need to focus on streamlining the numerous tools currently available for retirement planning so that they are clear and easier for citizens to utilize. Americans also need to make the effort to educate themselves on what options are available to them.

I look forward to hearing from the panel of experts we have today. I appreciate all of you being here and I look forward to the testimony on an issue that I know is tremendously important to many citizens in my State of Florida.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Martinez.

Our first witness will be Mr. Ben Stein. He really doesn't need an introduction. We have all seen him on TV, and we so appreciate his lending his celebrity, but more his financial acumen, to highlights this important issue for seniors.

I would be remiss if I didn't note "Ferris Bueller's Day Off." We have all seen that as an ad for DirecTV, but also "Win Ben Stein's Money." We are all interested in that, Ben, but we thank you for being here and helping us to understand how to develop a retirement portfolio that has some staying power.

He will be followed by Mr. Rob Henrikson, who is the chairman, president and CEO of MetLife. We all know Snoopy, as well, and appreciate the coverage you give to all the great American sporting events. But far more important than that is your discussion of long-term longevity risk and solutions to prevent individuals from outliving their savings.

He will be followed by Mr. Steve Utkus, who is a principal at the Vanguard Center for Retirement Research. Mr. Utkus will talk about how households should strike a balance between annuity income streams and asset income streams.

Then we will hear, as the clean-up hitter here, from AARP, Mr. LeRoy Gilbertson. He is a member of the National Legislative Council of AARP. He also is a part-time resident of my home State of Oregon. We especially want to note that and thank you for the money you spend in Oregon. Mr. Gilbertson will discuss the world

of retirement like it is and why we need to do a better job of helping people manage their assets in retirement.

Mr. Stein, take it away.

STATEMENT OF BEN STEIN, SPEAKER AND WRITER ON FINANCE MATTERS, ACTOR, AND HONORARY SPOKESPERSON FOR THE NATIONAL RETIREMENT PLANNING COALITION, LOS ANGELES, CA

Mr. STEIN. Thank you very much, Mr. Chairman and Honorable Senators. Thank you very much for allowing me to appear before you this morning. It is a great pleasure and a privilege.

I am here as honorary spokesperson for the National Retirement Planning Coalition, which is a group of 13 leading financial and health care industry organizations concerned about retirement readiness. This coalition was formed, or at least it was begun to be formed by NAVA, a trade group for the annuity industry, and we are very concerned, as you are.

In the waning months of World War II, Franklin Delano Roosevelt was asked what we were looking for after victory. He said we wanted for mankind to have four freedoms. One of them was freedom from fear. There are many kinds of fear and it is good to have freedom from all of them, but one of the most gnawing kinds of fear we would like to be free of is fear of financial insecurity. Franklin D. Roosevelt also hoped for freedom from want, a glorious freedom which enriches the lives of all who enjoy it.

These are great goals, but unfortunately for tens of millions of Americans, especially baby-boomers, there is nothing but fear of financial insecurity, nothing like freedom from fear or freedom from want where retirement is concerned.

The facts are not in serious dispute. There are about 77 million baby-boomers. Their average savings are far below what is needed for a comfortable or even decent retirement. I will just go off my statement for a second to say that in a very rough way, the average baby-boomer household has about $50,000 in liquid assets and about $115,000 if you add in the equity in their houses. That is not even remotely close to enough.

While millions are adequately prepared, tens of millions are not. They lack sufficient savings to provide enough income to get them even close to what they had as a lifestyle before they retired. Employers' defined plans are disappearing before our eyes day by day. Many of them rely on growing home values to tide them over, but real estate markets, as we are seeing right now, can shift dramatically, and what seemed like a castle suddenly becomes an ordinary cottage once again.

This problem hits women, minorities and farmers particularly hard, for a variety of reasons mostly having to do with various problems they have accumulating large savings. There is a lot of controversy about why this is particularly about women, but suffice to say whatever the reason is, women do not accumulate as much savings as men by a substantial margin.

On a relative basis, women, minorities and farmers are worst prepared for retirement than other groups, and the other groups are not doing terribly well either. The basic nub of the problem is we have a large chunk of the population who are likely to run out

of money when they are old and unable to work any longer; that is, they will be broke or in serious privation when they are at their most vulnerable and enfeebled.

To be sure, as the Chairman and ranking member said, there is one form of old age insurance that is guaranteed will probably not run out of money, and that is Social Security. But its payments are for most people fairly modest and all other forms of old age insurance can run out or are subject to market fluctuations.

It is great to have a lot of stocks, bonds, mutual funds and exchange-traded funds, and cash and real estate, but most people don't have those lucky charms in large quantities. People need about 15 to 20 times what they expect to live on when they retire. Very few people have 15 to 20 times what they need to live on, and even if they do have it, they can run out of it or it can lose value in market fluctuations.

The annuity issued by large, reputable insurance companies and other financial entities provides income until death, and often to the heirs for some time after death. The annuity, whether fixed or variable, provides income that by definition will last until the holder of the annuity has entered a place where money is presumably no longer needed. If it turns out to be needed, we are all in for a big shock.

Anyway, the variable annuity has the added benefit that because its benefits are based on the movement of stocks or bonds, or both, its payments can, and almost always do rise as inflation rises in retirement. That is the variable annuity. This is a major consideration because the recent retiree is by definition a long-term investor—something a lot of people forget.

The day you retire at age 65, you can expect to live a good 20 more years of life, and prices, if they rise even at the current modest rates, will come close to doubling in that period of time. They won't double, but they will come close to doubling. An annuity whose payments rise can be a godsend.

The problem is that at present the tax treatment of annuities discourages holding them. While the investments in them compound tax-free, the contingent gains from interest, dividends and capital gains are taxed at ordinary income rates as withdrawn. This is in stark contrast to other investments in non-tax-favored investments which actually can have lower tax rates than annuities, which are supposedly tax-favored.

This creates the unfortunate situation we have today in which the best vehicle for retirement—the annuity with guaranteed payments until death—is discouraged by the tax code. The Congress has before it a proposal to allow a modest amount of the contingent payments from annuity income to escape taxation. This is the Retirement Security for Life Act and this Act would result in a tax saving of, say, roughly $5,000 per year for the typical American with a fixed annuity paying $20,000 a year of taxable income who is in the 25-percent tax bracket.

It doesn't mean a thing to very rich people, but to very ordinary citizens trying to cope with retirement it could make a huge difference. Fairer tax treatment of annuities could encourage an extremely responsible form of retirement planning, annuitization,

along with other forms of investment. The more people who take that path, the better off we are as a society.

To be sure, it is still better to have a lot of savings in many different forms—stocks, bonds, real estate, mutual funds, ETFs. But annuities, with their unique guarantee of lifetime income, are a vital part of any sensible portfolio for retirement and it makes sense to encourage their use. Annuities can play a powerful role in achieving freedom from fear and freedom from want, and this is an incredibly significant achievement.

I appreciate your letting me come in to talk to you. I know you have a schedule that is busy on a scale most of us can't even contemplate and I thank you for your kind attention.

The CHAIRMAN. Thank you, Mr. Stein, and also we thank you for the public service you have given over the years as well.

Mr. STEIN. My pleasure.

[The prepared statement of Mr. Stein follows:]

Testimony of Ben Stein
Before the Senate Special Committee on Aging

Chairman, honorable Senators, thank you very much for allowing me to appear before you this morning. I am here as Honorary Spokesperson for The National Retirement Planning Coalition, a group of thirteen leading financial and healthcare industry organizations concerned about retirement readiness. The Coalition was formed by NAVA, a trade group for the annuity industry.

In the waning months of World War II, Franklin Delano Roosevelt was asked what we were looking for after victory He said we wanted for mankind to have Four Freedoms. One of them was "Freedom from Fear." There are many kinds of fear, and it's good to have freedom from all of them. One of the most gnawing kinds of fear we would like to be free of is fear of financial insecurity. Franklin D. Roosevelt also hoped for Freedom from Want, a glorious freedom which enriches the lives of all who enjoy it.

These are great goals, but unfortunately, for tens of millions of Americans, especially baby boomers, there is nothing but fear of financial insecurity, nothing like freedom from fear or freedom from want, where retirement is concerned. The facts are not in serious dispute. There are about 77 million baby boomers. Their average savings are far below what is needed for a comfortable or even decent retirement. While millions are adequately prepared, tens of millions are not. They lack sufficient savings to provide enough income to give them even close to what they had as a life style before they retired. Their employers' defined benefit plans are disappearing before our eyes, day by day. Many of them rely on growing house values to tide them over but real estate markets—as we are seeing right now—can shift dramatically and what had seemed like a castle suddenly becomes just an ordinary home again.

This problem hits women, minorities, and farmers particularly hard for a variety of reasons mostly having to do with various problems they have accumulating large savings. On a relative basis women, minorities, and farmers are worse prepared for retirement than other groups and the other groups are not doing terribly well either.

The basic nub of the problem is that we have a large chunk of the population who are likely to run out of money when they are old and unable to work any longer. That is, they will be broke, or in serious privation when they are at their most vulnerable and enfeebled.

To be sure, there is one form of old age insurance that is guaranteed and will probably not run out of money any time soon. That's Social Security. But its payments are, for most people, fairly modest. All other forms of old age insurance can run out or are subject to market variations. It is great to have a lot of stocks, bonds, mutual funds, and exchange traded funds—and cash, and real estate. But most people don't have those lucky charms in large quantities, and even if they do, they can run out or lose value in market fluctuations.

But the annuity, issued by large, reputable insurance companies, provides income until death, and often to the heirs for some time after that. The annuity, whether fixed or variable, provides income that by definition will last until the holder of the annuity has entered a place where money is (presumably) not needed. The variable annuity has the added benefit that because its benefits are based on the movement of stocks or bonds or both, its payments can and almost always do rise as inflation rises in retirement.

This is a major consideration because the recent retiree is by definition a long term investor. The man or women who retires at 65 can expect a good twenty more years of life, on average, and prices will almost certainly rise very considerably in that time. An annuity whose payments rise can be a godsend.

At present the tax treatment of annuities discourages holding them. While the investments in them compound tax free, the contingent gains from interest, dividends, and capital gains are taxed at ordinary income rates as withdrawn. This is in stark contrast to other investments in non tax favored investments, which actually can have lower tax rates than annuities which are supposedly tax favored.

This creates the unfortunate situation we have today, in which the best vehicle for retirement, the annuity with guaranteed payments until death, is discouraged by the tax code.

The Congress has before it a proposal to allow a modest amount of the contingent payments from annuity income escape taxation. This is the Retirement Security for Life Act. The Act would result in a tax savings of $5,000 per year for the typical American with a fixed annuity paying twenty thousand dollars a year who is in the 25 percent tax bracket. It does not mean a thing to millionaires, but to the ordinary citizen trying to cope with retirement, it could make a huge difference. Fairer tax treatment of annuities could encourage an extremely responsible form of retirement planning -- annuitization -- and the more people who take that path, the better off we will be as a society.

To be sure it is still better to have a lot of savings in many different forms—stocks, bonds, real estate, mutual funds, ETF's—but annuities with their unique guarantee of lifetime income are a vital part of any sensible portfolio for retirement, and it makes sense to encourage their use. Annuities can play a powerful role in achieving freedom from fear, and freedom from want, and this is not a trivial or insignificant achievement. I know you have a schedule that is busy on a scale most of us cannot even contemplate, and I know you are under tremendous pressures of time and work, so I greatly appreciate your taking the time for this session, and I thank you for your kind attention.

The CHAIRMAN. Mr. Henrikson.

STATEMENT OF C. ROBERT HENRIKSON, CHAIRMAN OF THE BOARD OF DIRECTORS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, METLIFE, INC., LONG ISLAND CITY, NY

Mr. HENRIKSON. Good morning, Mr. Chairman and members of the Special Committee on Aging. My name is Rob Henrikson. I am chairman, president and CEO of MetLife, a company with a heritage, expertise and commitment around helping millions of Americans manage assets and take risks throughout all phases of a lifetime.

Today's hearing is focused on the very public policy crisis that MetLife has taken on as a priority—helping Americans take the uncertainty out of retirement. I applaud the Committee's foresight and appreciate the opportunity you have given me to offer a few insights and potential solutions.

A fundamental transition occurs at the point of retirement, the transition from saving to living off one's savings. In that process of transition, individuals are increasingly on their own in managing multiple risks. My written testimony details the multiple risks one faces in retirement, but in the few minutes that I have now, I want to focus on what I believe is the most difficult task for an individual to manage in retirement, and that is longevity risk.

The good news is that Americans are living longer than ever. The bad news is that many will not both live long and prosper. The culprit is the unprecedented financial burden brought about by the shift away from traditional safety nets that once guaranteed income for life.

Today, most Americans realize their employer will not be providing them with a guaranteed monthly paycheck for life. Forced by competitive realities, many employers are discontinuing defined benefit pensions, sometimes exchanging them for 401(k)s. The reality is that the defined contribution plans such as 401(k)s have become the primary retirement vehicle, and that is just for people who have employment-based retirement plans.

But 401(k)s, while popular, have not yet proved to be successful if success is measured by their ability to generate adequate income for a generation of retirees. As the burden of retirement has increasingly shifted to the individual, we now are asking individuals to do something that they have never done before—fund and finance the rest of their lives.

To accomplish this, one's bag of cash must last through the 20, 30 or even 40 years that he or she will live in retirement. For past generations that were supported by pension plans, that job was handled by teams of actuaries and investment and administrative professionals performing services for pension plans who could leverage the law of large numbers and eliminate longevity risk for the individual.

The individual attempting to manage that risk for himself attempts the near-impossible. A 65-year-old man, for example, has a life expectancy of 20 years, until 85. By definition, therefore, his chances are 50–50 that he will live beyond age 85. So a 65-year-old man who is quite disciplined, has investment expertise and saves enough to make it to age 85 has a 50-percent chance of out-

living his assets. For the typical couple who reaches age 65, there is a 25-percent chance that one of them will live to 97.

If employee benefit trends, demographics and human nature are working against us, what is the answer? What steps can individuals take to ensure that their retirement savings will last as long as they do? Two steps can be taken that will encourage individuals to take action to secure their retirement income, no matter how short or long their future may be.

The first step I have alluded to is to encourage individuals to take action and join a risk pool. This is a solution for retirees who have diligently saved during their working years and want income for life. Individuals, no matter how smart and savvy, cannot go it alone and efficiently draw down their savings to last the rest of their lives. The risk they encounter is too great, since no one knows how long he or she will live.

In order to ensure that individuals do not run out of money in retirement, we must encourage Americans to harness the power of pooling that risk. The pooling concept is a powerful one. It is at the heart of all insurance, as well as defined benefit pension plans, and for that matter, as has been pointed out, Social Security.

In the case of Social Security, longevity risk is transferred to the social system. In traditional pension plans, longevity risk is transferred to the plan. On his or her own, an individual can pool the risk by turning to an insurance company. For insurers, pooling mortality risk is a core competency. A retiree would need to save about one-third more money to even attempt to replicate the economic power of an annuity pool. Even then, there would be no guarantee of income for life.

The second step I recommend is that government provide education and incentives. Tax incentives are really a form of education. People are quite simply more likely to consider an action if the government speaks for it as desirable public policy through positive tax consequence. A core proof of this is the employer-based retirement system.

In addition, however, individuals need better retirement education and advice. The most effective venue is the workplace. Fortunately, Congress is considering taking that important action right now in the pension conference. We must begin with the employer-based pension system and build on it because that is the major source of existing retirement savings. We must educate employees to make sure that they consider taking a portion of their savings at retirement and turn it into guaranteed income for life they cannot outlive, in effect creating a personal pension plan.

For the more than half of Americans whose only secure source of savings is outside the employer-based system, the same opportunity exists to join a risk pool through an annuity. The role of tax incentives added to education and advice can particularly help these Americans who can only rely on personal savings to fund the rest of their lives.

In closing, we must evolve from a way of thinking in which an investment implies optimism and insurance implies pessimism. The shift from organizational to individual responsibility requires this transformation. This is especially true at retirement age. Consumers get that the core of a smart financial plan isn't just about

a bag of cash at retirement age. It is about ensuring they are protected from the unexpected. Americans need help identifying and addressing these risks.

Recent legislation that Chairman Smith has introduced is heading exactly in the right direction. The Retirement Security for Life Act, S. 381, provides a good starting point to help individuals manage the risks of retirement by encouraging an income stream that cannot be outlived. I am pleased to point out that Senators Collins and Clinton on the Committee are cosponsors. I applaud these efforts and look forward to helping Congress work toward enactment, if not in this Congress, then in the 110th.

I would go one step further and suggest that the retirement income crisis justifies its own package of reform proposals that address the array of risks associated with the new set of challenges facing the next generation of retirees.

I want to thank the Committee again for holding this hearing today and for inviting me to testify. The goal of helping Americans achieve personal retirement income security is without question MetLife's No. 1 public policy priority.

I am happy to answer any questions you may have.

[The prepared statement of Mr. Henrikson follows:]

MetLife®

Testimony of

C. Robert Henrikson
Chairman of the Board of Directors, President and
Chief Executive Officer

MetLife, Inc.

on

"Managing Retirement Assets:
Ensuring Seniors Don't Outlive Their Savings"

before the

United States Senate
Special Committee on Aging

June 21, 2006
10:00 a.m.
Dirksen Senate Office Building, Room 106

Good morning Mr. Chairman and members of the Senate Special Committee on Aging. I am Rob Henrikson, chairman, president and CEO of MetLife, Inc., a global insurance and financial services company. MetLife has a heritage, expertise and commitment around helping millions of Americans manage assets and risks throughout all phases of a lifetime.

We find ourselves at a pivotal crossroads in retirement policy. In this new age of uncertainty and shift to individual responsibility, retirees can't "invest away" their financial risks, they must insure for them. Let me explain.

Americans are feeling a bigger financial burden today than ever before – and the need for personal risk management has never been greater. Most consumers know that they can no longer "count on" the government, their employer or the stock market for their financial security. The bursting stock market bubble in the early part of the decade was a wake up call that taught investors that no matter how sophisticated they are, market returns are not guaranteed.

The seismic shifts that have occurred in our society in the last few decades with regard to pensions, Social Security and health care are now requiring individuals – for the first time since the Great Depression – to fund and finance the risks that had previously been managed, in large part, by the government or their employer. Today, individuals are feeling a tremendous burden and a high level of anxiety at having to provide financial protection for their loved ones. And, with employers and the government less able to fund and protect individuals from the risks they face, individuals have been left largely on their own to deal with them.

We are moving quickly toward an "era of personal responsibility," and individuals are aware of the challenges that lie ahead. However, many are not ready to act. It may seem an insurmountable challenge to dedicate the time and energy to figure out – on their own – how to manage the risks they face. Yet, without insurance protection, the average consumer cannot adequately and efficiently self-insure the risks they will face throughout their lifetime such as becoming disabled, needing long-term care, or living beyond average life expectancy. Individuals are just not equipped to manage these risks on their own. They will either save too little or they will save too much. The latter, by the way, in a

society that has over 50% of its citizens living paycheck-to-paycheck is highly unlikely. If they transfer these risks to a broader pool of insureds by paying a premium, they can then live their lives without worrying about that exposure. Individuals understand this risk transfer with tangible belongings such as their cars and homes, but the concept is less well understood when talking about retirement security. Unfortunately, the reality is that today a significant number of Americans have no personal insurance or they are grossly underinsured.

So how did we get here? By and large, our parents and grandparents didn't need to worry about these issues. Take, for example, saving for retirement. Many in the WWII Generation and the Silent Generation sought out jobs with large corporations or the government that offered defined benefit pension plans. When workers retired, their "paycheck" continued for as long as they lived. It made them feel secure knowing that they worked hard throughout their life and, when they retired, they knew that they and their families didn't run the risk of running out of money.

Over the last two decades, the number of defined benefit pension plans has declined precipitously. In the mid-80s, the number of pension plans reached a peak of 112,000, with about one-third of American workers covered. According to the Pension Benefit Guaranty Corporation, today only 30,000 defined benefit pension plans remain. In recent years, many employers have chosen not to adopt defined benefit pension plans and others, including a number of Fortune 100 companies, have chosen to terminate or freeze their existing defined benefit pension plans in "exchange" for a larger 401(k) company match. According to Watson Wyatt Worldwide, the number of Fortune 1,000 companies that have frozen or terminated their defined-benefit pension plans jumped sharply from 34 in 2001 (5% of Fortune 1,000 companies) to 71 (11%) in 2004.

MetLife

Prevalence of DB Sponsorship and Plan Freezing or Termination among FORTUNE 1000 Firms

	Total Pension Plan Sponsors	Frozen or Terminated Plans	Percentage of Pension Plan Sponsors with a Frozen or Terminated Plan	Total Active Pension Plan Sponsors
2004	627	71	11%	556
2003	633	45	7%	588
2002	624	39	6%	585
2001	638	34	5%	604

Source: Watson Wyatt Worldwide Analysis, June, 2005

For those of our parents or grandparents who weren't fortunate enough to have a defined benefit pension plan, they at least knew they could always rely on the promise of Social Security.

According to the Social Security Administration's Web site, one of the first American books on social insurance on which the concept of Social Security was designed, was written by a Columbia University economics professor named Henry Seager.

Seager explained the principle of old-age security based on social insurance in his 1910 book, "Social Insurance, A Program of Social Reform":

> *". . . The proper method of safeguarding old age is clearly through some plan of insurance. . . for every wage earner to attempt to save enough by himself to provide for his old age is needlessly costly. The intelligent course is for him to combine with other wage earners to accumulate a common fund out of which old-age annuities may be paid to those who live long enough to need it."*

Of course, Social Security works as long as there is always a larger pool of workers paying into the system compared to beneficiaries receiving payments from the system. However, exactly the opposite is happening today – life expectancy is increasing, while birth rates are declining.

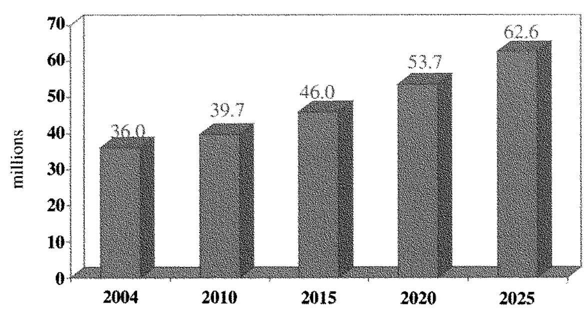
By 2012, according to the U.S. Government Accountability Office, Social Security's annual tax revenues are expected to be insufficient to cover its benefits payments. According to President Bush, "In 1950, there were 16 workers paying into the system for every beneficiary. In other words, the load was pretty light. Today, there are 3.3 workers per beneficiary. Soon there's going to be two workers per beneficiary."

Consumer Preparedness

With continued increases in life expectancy, the continuing shift from employer managed and funded traditional pension plans to individually controlled defined contribution plans, and the financial challenges faced by government supported programs, we are entering a period of great risk with regard to retirement

security. This triple threat is magnified exponentially when you factor in that the 36 million Americans over the age of 65 will grow to 62 million 20 years from now. With its projected growth, the 65+ segment of our society will represent 20% of the population (compared to 12% today). Furthermore, Cerulli Associates estimates that 25% of current 401(k) participants will retire by 2015. If that sounds far off, consider that the first baby boomers will reach the traditional retirement age of 65 in 2011.

The 65+ Population is Growing Rapidly

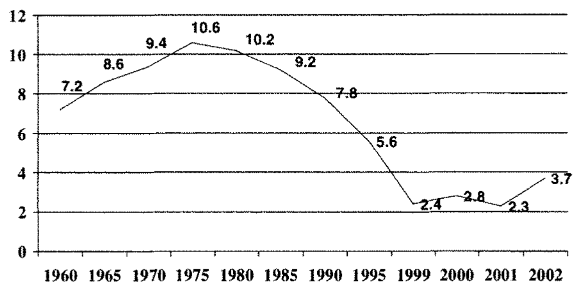


Source: U.S. Census Bureau

So how prepared for retirement are these millions of people? Americans' personal savings rate dipped into negative territory at minus 0.5% in 2005, something that hasn't happened since the Great Depression. This means that

Americans not only spent all of their after-tax income last year but had to dip into previous savings or increase borrowing.

Personal Savings - % of
Disposable Income



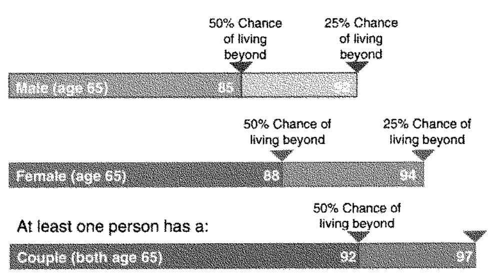
Source: Dept. of Commerce, Bureau of Economic Analysis, June 2003

In April 2006, the Employee Benefits Research Institute (EBRI) released its 16th Retirement Confidence Survey, a survey 1,252 individuals in the U.S. age 25 and older, that gauges the views and attitudes of working-age and retired Americans regarding retirement, their preparations for retirement, their confidence with regard to various aspects of retirement, and related issues. The RCS found that:

- More than half of workers saving for retirement report total savings and investments (not including the value of their primary residence or any defined benefit plans) of less than $50,000 (52%).
- The large majority of workers who have not put money aside for retirement have little in savings at all: Three-quarters of these workers say their assets total less than $10,000 (75%).

In 2003, MetLife created the Retirement Income IQ, which the company will be updating later this year. The 1,200 men and women between 56 and 65 years of age and within five years of retiring were asked 15 questions to assess their level of retirement preparedness. The findings revealed 95% of the respondents scored 60% or less; the average score was 33 on a grading scale of 100 points. Perhaps most disturbing was the misunderstanding surrounding how long people will live. A 65-year-old man has a 50% chance of living beyond his average life expectancy. That's what average life expectancy means – about half the population will live past that point and the other half won't. Yet when MetLife posed that question to 1,200 individuals, the majority of them thought there was only a 25% or less likelihood of living beyond average life expectancy. Only 16% of respondents replied correctly that a couple consisting of a 65 year-old man and woman have a 25% chance that one of them will live beyond age 97.

People Underestimate the Time Spent in Retirement



Source: Society of Actuaries 2000 Annuity Male and Female Tables

When you combine underestimating longevity with other findings, the picture gets even more unsettling. Respondents also *underestimated* how much money experts recommend they need for retirement and they *overestimated* the rate at which experts recommend they can safely withdraw from savings to help make their money last throughout their retirement. Over one-third believe they can safely withdraw 7% from their savings annually, even though planning professionals suggest limiting annual withdrawals to no more than 4%.

Our findings from the Retirement Income IQ are corroborated by many other industry studies. EBRI's 2006 Retirement Confidence Survey asserts that only four in 10 workers (42%) have attempted to calculate their savings needs for retirement. Additionally, many workers are counting on employer-provided benefits in retirement that are increasingly unavailable. Only 40% of workers indicate they or their spouse currently have a defined benefit plan, yet 61% say they are expecting to receive income from such a plan in retirement.

MetLife's 2005 Employee Benefits Trend Study found that approximately one-quarter (26%) of all baby boomers – the oldest members of whom will reach traditional retirement age in just five years – do not allocate any of their monthly household income to retirement savings vehicles such as 401(k)s, IRAs or annuities. As a result, 38% expect to remain behind in their retirement savings five years from now. Equally as concerning is the fact that employees age 51-60, who only have a few years left to accumulate a nest egg, are allocating, on

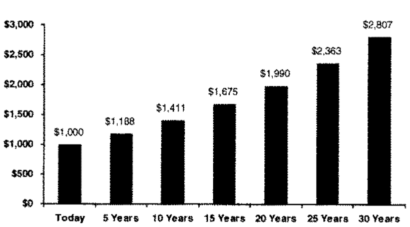
average, only 10% of their monthly household income to retirement savings products.

Risks in Retirement

Once they reach retirement, there are certain risks people face that they did not have to confront during their working years.

In its 2002 Retirement Risk Survey, the Society of Actuaries, together with EBRI and Mathew Greenwald, reports that the biggest financial concern for retirees and pre-retirees alike is **inflation**.

Income Required to Keep Pace With Inflation
Based on 3.5% rate



Over half of retirees and nearly two-thirds of pre-retirees are *very* or *somewhat* concerned that they will not be able to maintain the value of their savings and investments relative to inflation. In addition, pre-retirees expressed a greater concern than retirees over the possibility of not having enough money to pay for good health care (58% of pre-retirees are *very* or *somewhat* concerned as opposed to 43% of retirees). Pre-retirees are also more concerned with their ability to pay for quality nursing care.

Market volatility is another risk that can have a unique impact on retirees. Recent stock market experience has taught us all how quickly and how adversely our savings can be affected when exposed to a bear market. For people who are still saving, they have the benefit of time on their side and have a reasonable expectation of seeing their assets return to or even surpass pre-downturn levels. For retirees, however, market downturns, especially early on in their retirement years, can have a devastating impact.

Too often people rely on averages and base their planning (if any) on the assumption that their account will return the average. They research the historical market returns, plan to withdraw an amount less than the historical average return and then feel confident their money will last them well into their retirement years. However, a market downturn in retirement can have a much greater impact on a retiree's nest egg if they are taking withdrawals than if they are simply saving and still have time to recover from any stock market losses.

Using average returns while planning is dangerous because the market does not earn averages in any given year and once you withdraw in a down market, you realize losses never to be recovered.

While inflation and market risk can have a tremendous impact, **longevity risk** is, in my opinion, the biggest risk facing retirees. An earlier graph illustrated the average life expectancies for males, females and couples. When we have shared these statistics with consumers most expressed shock and some even disbelief. But the numbers are accurate and as we continue to make advances in medicine and adopt healthier, more active lifestyles the chances are the life expectancy tables will stretch out longer.

The reason longevity is the greatest retirement risk we face is because it is the only risk an individual cannot manage on his or her own. Market risk can be alleviated somewhat through asset allocation, and inflation risk can be addressed by investing in growth equities. But longevity risk only serves to exacerbate these other two risks by increasing the length of time an individual is exposed to them.

Managing Longevity Risk

With Social Security and pensions becoming a smaller piece of the overall retirement equation, individuals will need to turn to mortality pooling to convert their retirement savings into guaranteed income that they cannot outlive.

The reality is, unless you are extremely wealthy like Bill Gates or Warren Buffett, these risks cannot be reasonably solved through investments alone. The use of pooled risk is still an individual's best and most cost effective defense, because when a group is assembled and mortality experience is pooled, monumental efficiencies take place. An average retiree, for example, would need to have saved about one-third more to attempt to replicate the power of a mortality pool and, even then, could still risk running out of money.

The pooling concept is a powerful one that's at the heart of all insurance products (as well as the mortality element within defined benefit plans). Individuals cannot self-insure the risk of outliving their money because they cannot accurately predict how long they will live. Longevity creates a much smaller risk for large

defined benefit pension plan sponsors since the "law of large numbers" permits them to fund for the average life expectancy of the entire group of retirees. When a large group of retirees are pooled together, the retiree who lives a long time is offset by the retiree who dies early.

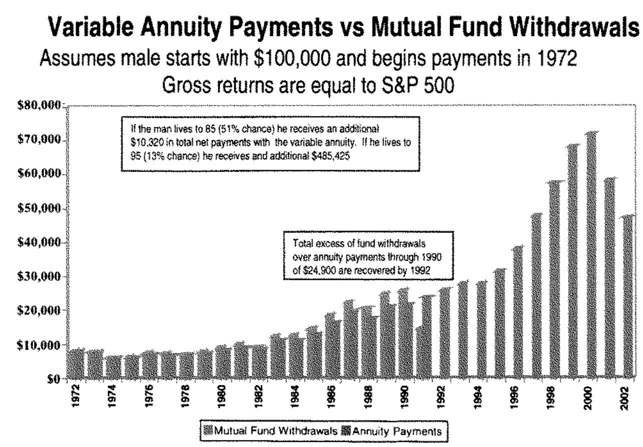
The longevity risk faced by an individual retiree is comparable in magnitude, but not in nature, to the investment risk that he or she faces at retirement. Whereas an individual can decrease his investment risk by changing his investment strategy, there is no way that an individual can, on his own, reduce his longevity risk.

The only way that an individual can manage this risk is by converting his savings to an annuity. Annuities, like a large plan sponsor, use the averaging effect created by pooling together the mortality experience of a large number of annuitants. Through annuities, a retiree can manage longevity risk and may choose to keep some portion of investment risk (along with its potential return) through a variable income annuity. Or a retiree can manage both longevity and investment risk with a fixed income annuity. An income annuity, also known as

an immediate or payout annuity, is an insurance product that converts a sum of money into a stream of income that is guaranteed to last throughout the lifetime of the policyholder. It is, in effect, a personal pension plan and it works because the insurance company pools the lives of many individuals.

The Value of Annuities

The core value of an annuity is its guarantee of lifelong income. To demonstrate this benefit, we compared it to another popular method of generating income in retirement -- systematic withdrawals from an investment portfolio.



Annual fund withdrawals are equal to annuity payments made before the reduction of a 95 basis point separate account fee. Other charges and expenses apply to a continued investment in mutual funds and annuities. If these charges and expenses and applicable taxes had been factored into the above example the value of the payments would be reduced. Opening balance of the IRA mutual fund account is $100,000 with returns equal to those of the S&P 500 Annuity payments are based on an initial purchase amount of $100,000 for a single life male age 65 and assume a 100% variable option using an AIR of 4% and investment returns equal to those of the S&P500. Should the annuitant die before age 84 in this hypothetical example, annuity payments would cease whereas the balance in the mutual fund would pass to the accountholder's beneficiary or estate. Certain income or lump sum options are available for designated beneficiaries of annuity contracts. Costs for these options will reduce income payments to the annuity holder. The above example is hypothetical and does not represent the income stream of any MetLife product. Actual income will fluctuate and there is no guarantee they will increase in value. Past performance is not a guarantee of future results.

The graph compares the results of systematic withdrawals from a fund with an opening balance of $100,000 versus a variable immediate annuity purchased with this same amount. The fund withdrawal is equal to the payments generated from the annuity before the reduction of the fees associated with the annuity. We assume the return on both the fund and the annuity is equal to the S&P 500 and the payments and withdrawals started in 1972. The fund would have been depleted by 1991 (age 84 in this example), whereas the annuity will continue income payments for as long as the annuity owner lives. Considering that a 65-year-old man has more than a 50% chance of living beyond this age, there is a very good chance that he will run out of money without an annuity.

The Outlook

What can we do to help consumers who are beginning to understand the new realities of the shift of these risks to their shoulders, and how can we make sure that they are adequately protected from these risks?

We believe annuities can be an important part of the solution to helping people secure guaranteed lifetime income in retirement. Market research indicates that there is greater receptivity to annuities once their benefits are explained. Furthermore, we are beginning to see more in the way of innovative product design that is intended to meet the needs of today's retirees. For example, we are seeing more products offer liquidity options that allow purchasers to access money in an emergency. In addition, products are offering features (such as, more investment choices, transfers and rebalancing) that provide individuals with the flexibility and control that they are used to seeing within their 401(k) plans. In this world of uncertainty, consumers, as you know, are becoming increasingly risk averse. Consumers "get" that the core of a smart financial plan isn't about returns or yields; it's about ensuring that their families are protected from the unexpected. They want help identifying and addressing the risks within their control to protect their financial future.

They also understand that the core of insurance is a guarantee from their insurer that they can't get from other financial products. It's about removing the "un" from uncertainty. They want guarantees to protect their wealth and income

against risks; guarantees that they can count on that will protect them and their families throughout their lives. For now (and we think the foreseeable future), consumers clamor for guarantees; they respond more and more strongly to anything with the word "guarantee" in it.

One of the most important components of the decision to purchase insurance, particularly insurance benefits that will be paid at some future date or for as long as the policyholder lives, is the selection of a company that has the financial strength to keep its promises 20, 30 or even 50 years in the future. When described in more robust and descriptive terms, "guarantees" and "financial strength" are extremely motivating decision drivers for the consumer.

However, we must evolve the traditional paradigm in which there is an inherent conflict between "insurance" and "investments." According to Daniel Kahneman, the Nobel prize-winning economist, "If clients' risk tolerance differs when viewing investments versus insurance, perhaps it is because investment implies optimism and insurance implies pessimism. Investment involves the expectation of an improvement in one's wealth, whereas insurance represents an expense - a

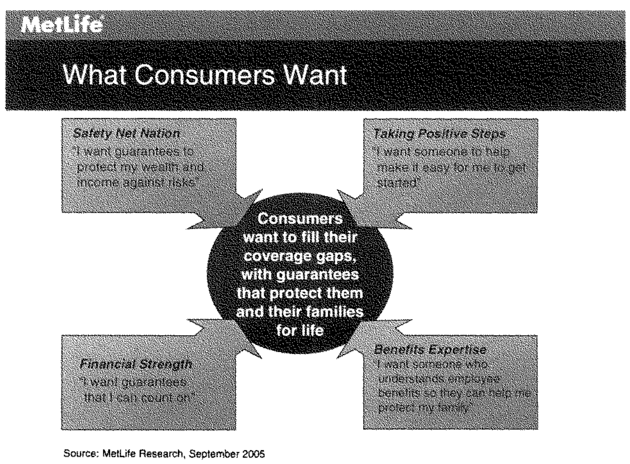
decrease in wealth." We don't look at it that way. Insurance is <u>the</u> foundation for any sound financial plan or investment portfolio and, according to MetLife's research, 70% of consumers expect insurance to help improve their quality of life.

Another trend is emerging. The insurance industry is seeing that many people nearing retirement are more conservative about investing in equity markets because they are concerned about potential loss of value, but realize equity and bond markets have the potential to generate returns greater than inflation. That's why annuity products that provide some upside opportunity, but also a minimum guaranteed value such as income for life, are becoming very popular. In fact, of the roughly $33 billion of third quarter 2005 variable annuity sales, 70% of individuals have elected some type of guaranteed income feature (JP Morgan North America Equity Research, January 5, 2006). This clearly indicates that individuals realize they need to save more and they need equity exposure to fight inflation over the long term. But, they also understand this comes with risk given stock market downturns. However, many individuals still don't completely understand that they have both stock market risk <u>and</u> longevity risk. That is why

the insurance protection of the living benefits on variable annuities is of significant value to ensuring the success of income for life.

Consumers want a financial plan – and they need one built on a solid foundation of insurance – but few know how to create one.

Consumers want to fill their coverage gaps with guarantees that protect them and their families for life. Consumers are craving advice.



Until now, the information and advice consumers have been getting is not making them feel comfortable or smart. People want and need simple, straightforward, jargon-free, trustworthy information no matter their level of experience. There is a strong need for an advisor who can give consumers the guidance they desire.

They want to work with an advisor who can help them identify the risks to be protected against, as well as help them grow their wealth. It's not an either/or.

We need to shift the discussion from assets to income and we need to educate employees and retirees – working to redefine the priority and language of retirement. We no longer think that individuals should focus on a bag of cash as the end game. Rather, they should focus on how to create a "paycheck for life" and protection for their future. After all, most people have been making all of their financial decisions for themselves and their families around their income their entire lives.

One of the biggest challenges faced by the boomers is the ability to calculate – and generate – the income they will need to comfortably live 20, 30 or more

years in retirement. A "new generation" of income annuities, which are supported by a range of educational programs and tools, provides lifetime guarantees with a range of options designed to provide flexibility and help to overcome the common objections people have to annuitization. As the boomers retire, we expect many of them to convert their 401(k) nest egg into guaranteed income that they can't outlive.

We also must work to encourage younger Americans to think in terms of buying future pieces of income to create their own "personal pension" rather than only accumulating retirement assets.

Important Steps

If benefit trends, demographics, and human nature are working against us, what's the answer? What steps can individuals take to address this perfect storm? There are two steps that can be taken that will encourage individuals to take action to secure their financial future, no matter how short or long that future may be.

The first is to encourage individuals to take action and join a risk pool. This is one solution for retirees who have diligently saved during their working years and want their savings to last throughout their lifetime. Individuals who are not part of a group cannot self-insure the risk of outliving their money because they cannot predict how long they will live.

The second step is related to the first; policymakers need to provide education and incentives. Tax incentives really are a form of education. People are quite simply more likely to consider an action if it has a positive tax consequence. The core proof of this is the employer-based retirement system. But education is more than just tax incentives. Individuals need better retirement education and investment advice. A logical place for education to be provided is at the workplace because the employment-based system is the source of most of the existing retirement savings. We must educate employees, who have the accumulated retirement assets, at the point of retirement to make sure they consider taking a portion of their assets and guaranteeing income they cannot outlive. An income annuity is the best way to accomplish that; a personal pension plan of sorts.

For the more than half of Americans whose only source of savings is outside the employer-based system, the same opportunity exists to join a risk pool to transfer longevity risk off of their shoulders. Their need for this assistance is perhaps much greater; as they must individually shoulder the dual challenge of accumulating sufficient savings and making it last through retirement. The role of tax incentives, education, and advice can especially help Americans who only have personal savings meet this challenge.

So we find ourselves at a pivotal crossroads.

In this new age of uncertainty, consumers can't invest away their financial risks; they must insure for them.

Millions of people are on the cusp of having to worry about funding and financing the rest of their lives, and the life insurance industry is ready to offer the solutions they will need. The burden has shifted from the government and the corporation

to the individual, and they are now responsible, in large part, for their own personal protection plan. At the same time, we know that they cannot self insure their morbidity, mortality and longevity risks. Investments, while a powerful tool for helping consumers grow their wealth, cannot by themselves adequately fund and finance the cost of caring for their own or a loved one's long-term illness. Nor can it adequately ensure that an individual will not run out of money if they live a long and healthy life.

Recent legislation Chairman Smith has introduced is heading exactly in the right direction. The Retirement Security for Life Act (S. 381) provides a good starting point to help individuals manage the risks of retirement by encouraging an income stream that cannot be outlived. I am pleased to point out that Senators Collins and Clinton on the Committee are co-sponsors. I applaud these efforts and look forward to working toward enactment if not in this Congress then in the 110th. I would go one step further and suggest that the retirement income crisis justifies its own package of reform proposals that address the array of risks associated with the new set of challenges facing the next generation of retirees.

I want to thank the Committee again for holding this hearing today, and for inviting me to testify. The goal of helping Americans achieve personal retirement income security is, without question, MetLife's number one public policy priority.

The CHAIRMAN. Thank you so very much, Mr. Henrikson, for your testimony and, frankly, the importance of the products that you are offering to the American people as a way to secure their retirement.

Stephen, take it away.

STATEMENT OF STEPHEN P. UTKUS, DIRECTOR, VANGUARD CENTER FOR RETIREMENT RESEARCH, VALLEY FORGE, PA

Mr. UTKUS. Thank you, Chairman Smith and Ranking Member Kohl, for this opportunity to discuss the income and retirement phase with you and members of the Committee.

I am reminded by my colleagues at Vanguard that millions of retired Americans already face these issues today of generating income and managing their savings in retirement. So this is not a new issue for individuals in America, but the issue obviously is going to take on greater urgency with the prospective retirement of the baby boom and the shift of the private pension system to defined contribution plans.

At Vanguard, we have developed somewhat of an expertise in thinking about how people make these choices throughout their lives and I thought I would devote my remarks today to that perspective, thinking of a household approaching retirement and making important choices about their life savings.

So the first decision interestingly enough has nothing to do with managing your life savings, but it has to do with the question of when to stop working. For many Americans, the real risk of the retirement phase is the risk of retiring too early. You can see this in our own research, at the Vanguard Center for Retirement Research. You can see it in the most recently issued Retirement Risk Index from the Boston College Center for Retirement Research.

Delaying retirement by 2 or 3 years can dramatically reduce risks in retirement. A longer period of work means higher Social Security, more in savings, additional investment returns, and for those covered by pensions often a higher benefit. It also means fewer years of spending.

In recent years, there have been many encouraging developments in Washington on this question of the timing of retirement. Social Security's normal retirement age is rising to 67, a reflection of longer life expectancies. In the private sector, employers with defined benefit programs have been phasing out incentives for early retirement.

The shift to defined contribution plans is also very encouraging in this regard. Individuals in defined contribution plans typically work several years later because those plans lack the sort of service-related incentives of a DB plan. Hybrid plans like cash balance plans probably have a similar effect to encourage people to remain in the workforce, although there is little research on this particular topic.

So what else can you do to help in this area? One important direction is to continue support for phased retirement, which would enable individuals to simultaneously contribute to and withdraw from qualified retirement programs as they approach and enter retirement. It's particularly important I think, to go beyond the regulations that have been recently issued by the IRS.

Working for several more years is one way that the baby-boom generation will be able to finance its retirement—if I can counteract a bit of the gloom around the table concerning the prospective retirement of the baby boom. We have all heard of the traditional three-legged stool: Social Security, an employer pension, personal savings. For the baby-boom generation, there is a new three-legged stool. It will be Social Security, workplace and personal savings, and work—especially in the early years, throughout the 60's and early 70's, for those who haven't saved for retirement.

The second question for households facing retirement is how to manage your accumulated resources. We could spend many hours debating this issue of annuity versus asset income. Most experts agree that households need both. The only point is one of degree. What portion of your retirement should be annuitized and what portion should be in the form of a pool of assets?

In recent years, if you look at the data, it appears that many households have voted with their feet, finding that the cost of longevity insurance is simply too high. Many private DB plans have introduced lump-sum payments. Few DC plan participants take up annuities when they are offered. In the private market for income annuities purchase rates are low.

So why might households prefer asset income over annuity income in retirement? One reason simply is Social Security. Today, Social Security is the principal source of income and the main annuity provider for six out of ten American retirees—and a group which includes the most economically vulnerable retirees. Social Security has the benefit of being Government-guaranteed, inflation-indexed and exceptionally low cost. Longevity risk is not pooled over a group of customers, but over the entire Nation.

Now, a second reason that households focus on asset income is flexibility. A household with a pool of liquid assets is better able to address its unanticipated needs in retirement. These include major capital or consumer expenses, but they also may include out-of-pocket medical costs and the costs of nursing home care. A pool of assets can also be invested and grow over time, offering protection against inflation.

There is a third reason that many households are choosing asset income. Retirement wealth and financial literacy have been rising, especially over the prior generations, and households are willing to shoulder more responsibility for managing their assets.

For middle-income households, the dominant asset holdings are bank CDs and mutual funds. Affluent households also own individual stocks, bonds, ETFs, investment real estate, and so forth. Households who own these assets rely on regular interest and dividend payments from these assets. As long as they do not spend capital, it is possible to maintain these sources of income indefinitely. In addition, the financial planning community has devised strategies, such as the so-called 4-percent spending rule, to help people draw down their savings in an orderly way.

Just to go off my official record for a moment, last night I calculated, if you had $100,000 in life savings, what you would get from a variety of income-producing vehicles today in America. If you went to your local bank and bought 5-year CDs, you would get roughly $400 per month in income. A little bit of self-promotion

here: with the Vanguard GNMA fund, our long-term corporate bond fund, you would take capital market risk, but you would have incomes ranging from our $400 to $500 a month. If in our partnership with AIG, you bought a 100-percent joint and survivor annuity, you would get $600.

For many households evaluating those choices, they say they can receive two-thirds to 80 percent of the income of an annuity and retain control of their assets, versus giving up their entire life savings to a third party. This flexibility, and the choice between income levels versus flexibility, is why you see households pursuing asset-based income.

So how can you help in this regard? At Vanguard, we anticipate a lot of innovation in this area from insurers like MetLife, banks, asset management firms like Vanguard, and so on. On the annuity side, one of the most intriguing ideas, we think, is longevity insurance, an annuity that pays a benefit only if you reach a certain age like age 85. Some reform could particularly help this new type of annuity.

Another issue we haven't really talked about today is the issue of translating home equity into a reasonable income through the reverse mortgage market. Eighty percent of retirees own their own homes and policymakers should do much more to encourage this market.

Finally, on the asset income side, a topic worth considering, as Senator Martinez pointed out, is tax simplification broadly. The tax rules governing different types of accounts and plans and the rules governing the taxation of Social Security are simply too complex.

One positive step would be eliminating the required minimum distribution rules, as the Joint Committee on Taxation has recommended. These rules were designed with the Treasury's revenue stream in mind. They were not designed as a long-term pay-down strategy for individuals. So eliminating those rules would help retirees and they would help us as financial services firms to design income programs for retirees. Finally, I agree with everyone that efforts to encourage financial planning and investment advice make more sense.

So as I mentioned at the outset, retiree households have been making an investment in savings choices already for many years. But now with the upcoming retirement of the baby boom, many more Americans will be called upon to make these critical choices. By retiring just a few years later and by using a mix of annuity and asset-based income programs, it is likely that many will be able to meet this challenge in the decades ahead.

Thank you.

[The prepared statement of Mr. Utkus follows:]

Remarks on the Retirement Spending Phase

Before the Senate Special Committee on Aging

Stephen P. Utkus, Director, Vanguard Center for Retirement Research

June 21, 2006

Thank you, Chairman Smith, for the opportunity to discuss the income or spending phase of retirement with members of the Committee. I am reminded by my colleagues at Vanguard that today, millions of retired Americans are already dealing with the issues of generating income and managing their savings in retirement. But the question will take on greater urgency with the retirement of the baby boom generation, and with the shift of the private-sector retirement system to defined contribution plans.[1] At Vanguard, we have developed some expertise in understanding financial decision-making by individuals, and I thought that I would devote my remarks today to that perspective: of a household making choices at the point of retirement and beyond.

The first decision households face in the retirement phase is not how to spend their assets—instead, it is the decision on when to stop working. For many Americans, there is a real risk of retiring too early. This risk is evident in our own research at the Vanguard Center for Retirement Research, as well as in the Retirement Risk Index recently issued by the Boston College Center for Retirement Research. Delaying retirement by two or three years can dramatically reduce financial risks in retirement. A longer period of work means higher Social Security benefits, more in savings, additional investment returns, and, for those covered by pensions, often a higher benefit. It also means fewer years of retirement spending.

In recent years, there have been several encouraging developments on this question of the timing of retirement. Social Security's normal retirement age is rising to 67, a reflection of longer life expectancies. In the private sector, employers with defined benefit plans have been phasing out incentives for early retirement. The shift to defined contribution plans is also encouraging: DC plan participants typically work several years longer than DB plan participants because DC plans do not have the service-linked benefits of the typical DB plan. Hybrid plans probably have a similar effect.

What else can policymakers do to help? One important direction is to continue support for "phased retirement," which would enable individuals to simultaneously contribute to, and spend from, qualified benefit programs. Working for several more years is one way that the baby boom generation will be able to finance its retirement. We've all heard of the traditional three-legged stool: Social Security, an employer pension, and personal savings. For the baby boom generation, retirement will be built on a new three-legged stool: Social Security, workplace and personal savings, and work.

The second question households face in retirement is how to manage their accumulated resources. We could devote many hours of discussion to the choice between annuity income and asset income. As you know, annuities help protect against longevity risk—the risk of outliving one's savings—while a pool of assets provides flexibility in dealing with unplanned expenses. Most experts agree that households need both. The only point of debate is one of degree: What proportion of retirement savings should be annuitized, and what proportion should remain as a pool of assets? In recent years, it appears that many households have "voted with their feet," finding the cost of longevity insurance in annuities to be too high. Many private-sector DB plan have introduced

lump-sum payments. Few DC plan participants take up annuities when they are offered. In the private market for income annuities, purchase rates are low.

Why might retired households prefer asset income over annuity income? One reason is Social Security. Today, Social Security is the principal source of income and the main annuity provider for six out of ten American retirees.[2] Social Security has the benefit of being government guaranteed, inflation indexed and exceptionally cost-effective. Longevity risk is also pooled across the entire nation.

A second reason for the focus by households on asset income is flexibility. A household with a pool of liquid assets is better able to address unanticipated expenses in retirement. These include not only major capital or consumer expenses, but also out-of-pocket medical costs and the cost of nursing home care. A pool of assets can also be invested and grow over time, offering protection against inflation.

There is a third reason that households may prefer asset income. Retirement wealth and financial literacy have been rising, and households are willing to shoulder more responsibility for managing their assets. For middle-income households, the dominant asset holdings are bank CDs and mutual funds; affluent households also own individual stocks and bonds and investment real estate. Households who own these assets rely on regular interest and dividend payments from these vehicles. As long as investors do not spend capital, it is possible to maintain these sources of income indefinitely. In addition, the financial planning community has devised strategies, such as the "4% spending rule," to help individuals draw down their savings.

What can policymakers do to help in the annuity-income versus asset-income decision? At Vanguard, we anticipate much innovation in this area in the coming

years—from insurance companies, banks, and asset management firms. On the annuity side, one of the most intriguing ideas is "longevity insurance"—an annuity that pays a benefit only if you live beyond a certain age, such as 85. Some reform could encourage this new type of annuity. Another issue is translating home equity into an income stream. Eighty percent of retirees own their own homes, and policy should do much more to encourage the reverse mortgage market. On the asset income side, a topic worth considering is tax simplification broadly. The tax rules governing different types of accounts and plans, as well as the taxation of Social Security, are simply too complex. One positive step would be eliminating the required minimum distribution (RMD) rules, as the Joint Committee on Taxation has recommended.[3] These rules were designed with the Treasury's revenue stream in mind, not as a long-term pay-down or income strategy for individuals. Eliminating the RMD rules would help retirees, and would assist financial services firms in designing income programs for retirees. Finally, efforts to encourage financial planning and investment advice make sense—to help individuals choose an appropriate retirement date and to develop retirement income strategies.

As I mentioned at the outset, retired households have been making investment and savings choices for years. But now, with the upcoming retirement of the baby boom generation, many more Americans will be called on to make critical choices about generating an income and investing their assets in retirement. By retiring a few years later, and using a mix of annuity- and asset-based income programs, it is likely that many will be able to meet this challenge in the decades ahead.

Endnotes

[1] According to the 2004 Survey of Consumer Finances, about one-quarter (26%) of older retirees (age 75 and older) owned a retirement account, which broadly defined included a 401(k) plan, an IRA or similar account. This figure rises to nearly two-thirds (63%) for those in their prime working years (age 45-54).

[2] According to the Social Security Administration, *Income of the Population 55 or Older, 2004,* 60% of age 65 and older households receive 50% or more of their income from Social Security. Table 6.A1, p.109. For 31% of households age 65 and older, Social Security represents 90% or more of income.

[3] Joint Committee on Taxation, 2001. *Study of the Overall State of the Federal Tax System and Recommendations for Simplification, Pursuant to Section 8022(3)(B) of the Internal Revenue Code of 1986* (JCS-3-01). See in particular: *Volume II: Recommendations of the Staff of the Joint Committee on Taxation to Simplify the Federal Tax System,* pp. 194-197.

Written Testimony on Managing Retirement Assets

Before the Senate Special Committee on Aging

Stephen P. Utkus, Director, Vanguard Center for Retirement Research

June 21, 2006

Chairman Smith and Ranking Member Kohl—Thank you for the opportunity to address the Committee today on this critically important question of managing assets in retirement. At Vanguard, we are reminded that in many ways, it is not a particularly new problem: after all, millions of retired Americans today are using a variety of vehicles to generate income and manage their savings throughout retirement. Yet the question will take on greater urgency in the future, both with the prospective retirement of the baby boom generation, and with the gradual shift of the private-sector retirement system to defined contribution plans.

In 2004, according to the Federal Reserve Board's Survey of Consumer Finances, nearly two-thirds of American households in their prime working years owned an individually directed retirement account, which broadly defined included 401(k), 403(b) or 457 accounts, IRAs, small business retirement plans, or similar arrangements (Table 1). By comparison, only about one-quarter of older retirees held such an account. As baby boomers in the workforce enter their retirement years, the challenge of managing these assets will only grow over time.

Table 1. Incidence of retirement accounts by age

Age	% of households
45-54	63%
55-64	59%
64-74	44%
75+	26%

Source: Survey of Consumer Finances (2004)

At Vanguard, we have developed some expertise in understanding financial decision-making by individuals, and accordingly our remarks are devoted to that perspective: of a household making choices at the point of retirement and beyond.

The Risk of Retiring Too Early

In the research and policy worlds, many of us tend to focus exclusively on the risks that arise once a household has retired. But in reality, the first and most critical decision a household faces is not how to spend one's savings—instead, it is the decision on when to stop working. For many Americans, there is a real risk of retiring too early. This risk is evident in our own research at the Vanguard Center for Retirement Research, as well as in the Retirement Risk Index recently issued by the Boston College Center for Retirement Research. Delaying retirement by several years can dramatically reduce financial risks in retirement. A longer period of work means higher Social Security benefits, more savings, additional investment returns, and, for those covered by pensions, often a higher benefit. It also means fewer years of retirement spending. Of course, not everyone will be able to continue to work, particularly those who suffer from declining health. But broadly speaking, older Americans are healthier than in the past, and so are better able to participate in the workforce for a longer period.

In recent years, there have been several encouraging policy developments affecting the timing of retirement. Social Security's normal retirement age is rising to 67, a reflection of longer life expectancies. In the private sector, employers with defined benefit plans have been phasing out incentives for early retirement. The shift to defined contribution plans is also encouraging in this regard: DC plan participants typically work

several years longer than DB plan participants because DC plans do not have the service-linked benefits of the typical DB plan.[1] Hybrid plans probably have a similar effect.

Policy Focus on Phased Retirement

What else can policymakers do to help to encourage individuals to work longer—and avoid the risk of retiring too early? One important direction is to continue support for "phased retirement," which would enable individuals to simultaneously contribute to, and spend from, qualified benefit programs. Proposed IRS regulations on this topic are narrow in scope, and more needs to be done in this area. Chairman Smith and Ranking Member Kohl, your own efforts in highlighting this issue are very much appreciated.

Working for several more years is one way that the baby boom generation will be able to finance its retirement. We've all heard of the traditional three-legged stool: Social Security, an employer pension, and personal savings. For the baby boom generation, retirement will be built on a new three-legged stool: Social Security, workplace and personal savings, and work. Importantly, encouraging a longer period of work is one critical way that Congress can help improve financial preparedness for Americans who arrive at retirement with inadequate savings.

The Risks of Managing Retirement Assets

The second question households face in retirement is how to manage their accumulated resources. We could devote many hours of discussion to the choice between annuity income and asset income. An annuity helps protect against longevity risk—the

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[1] Leora Freiberg and Anthony Webb, 2003. "Retirement and the Evolution of Pension Structure." NBER Working Paper 9999. National Bureau of Economic Research, Cambridge, MA. www.nber.org.

risk of outliving one's savings—while a pool of assets provides flexibility in dealing with unplanned expenses. Most experts agree that households need both. The only point of debate is one of degree: What proportion of retirement savings should be annuitized, and what proportion should remain as a pool of assets?

In recent years, it appears that many households have "voted with their feet," finding the cost of longevity insurance in annuities to be too high. Many private-sector DB plans have introduced lump-sum payments in response to employee demand.[2] Few DC plan participants take up annuities when they are offered. In the private market for income annuities, purchase rates are low. Despite the potential benefits of income annuities, only a small number of consumers seem genuinely inclined to choose them.

Why is this so? One possibility is that consumers are simply myopic about longevity risk and underestimate the chances of living a long life. This does not appear to be the case, however. According to our research, individuals are quite accurate in estimating life expectancies, but actually *overestimate* the chances of living to a very old age. For example, individuals estimate that there is a 26% chance of living to age 100—even though the chance is only 2% according to standard morality tables.[3] By this measure, households seem all too cognizant of the risk of outliving their resources.

Indeed, other reasons appear to explain why retired individuals prefer asset income over annuity income. These include the prevalence of Social Security, a need for flexibility in retirement spending, the desire to control one's savings, and bequests.

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[2] In 2003 about half (48%) of private-sector workers with a DB plan had access to a lump sum option at retirement. *National Compensation Survey, Employee Benefits in Private Industry in the United States, 2003,* U.S. Department of Labor, Table 47, p. 62. www.bls.gov.

[3] Vanguard Center for Retirement Research, 2004. "Expectations for Retirement: A Survey of Retirement Investors." Malvern, PA. www.vanguardretirementresaerch.com.

The role of Social Security. Social Security is an important reason why retirees may prefer asset income over annuity income. Today, Social Security is the principal source of income and main annuity provider for six out of ten American retirees (Table 2). For 31% of older Americans, Social Security constitutes 90% or more of their income. In effect, this population—the most economically vulnerable of America's retirees—receives nine out of ten dollars of income (or more) in annuity form. This group probably does not need more annuity income; instead, it needs more savings and assets. Another 29% of older Americans rely on Social Security for between 50% and 90% of their income. Some in this group will have a private- or public-sector pension paid in annuity form, and most will have workplace or personal savings. Even if all of their retirement savings are in the form of assets, Social Security would still account for 50% to 90% of total income. With a large proportion of income already in annuity form, only a small part of this second group is likely to need additional annuitization.

Table 2. Importance of Social Security annuity income, Age 65+

% of households	Social Security as % of income
31%	90% or more
29%	50% to 89%
40%	Less than 50%

Source: Social Security Administration, *Income of the Population 55 or Older, 2004,* Table 6.A1, p.109.

For the remaining four out of ten households, Social Security represents less than half of total income, and so there is greater potential for the use of private annuities. But these households are often the most affluent retirees, with substantial private resources beyond Social Security. They have a greater propensity and skill to manage their assets, and to make an independent and informed choice of annuity versus asset income.

Put simply, Social Security is the principal annuity provider for many Americans. It has the unique benefit of being government guaranteed, inflation indexed and exceptionally cost-effective. As well, longevity risk in Social Security is pooled across the entire nation. Today, private annuities suffer from "adverse selection"—healthier retirees typically purchase private annuities, and that makes them less financially attractive for those in poorer health (who are often lower-income households). For many retirees, Social Security may represent all the annuity income they need.

Flexibility. Flexibility is a second important reason for the focus on asset income by households. A household with a pool of liquid assets is better able to address unanticipated expenses in retirement. These include not only major capital or consumer expenses, but also out-of-pocket medical costs and the cost of nursing home care. A pool of assets can also be invested and grow over time, offering protection against inflation.

Control. A third reason that households may prefer asset income is the rising interest in self-direction and personal control in household financial matters. Retirement wealth and financial literacy have been rising in tandem, and many households are increasingly willing to shoulder responsibility for managing their assets in retirement. For middle-income households, the dominant asset holdings of choice are bank CDs and mutual funds; affluent households also own individual stocks and bonds and investment real estate. Households who own these assets rely on regular interest and dividend payments from these vehicles. As long as investors do not spend capital, it is possible to maintain these sources of income indefinitely. Using a simple rule, such as "spend income and not principal," households can counteract longevity risk and its impact on their retirement program. The financial planning community has also devised strategies,

such as the "4% spending rule," to help individuals draw down their savings in a disciplined fashion.

Bequests. A final benefit in terms of flexibility is the ability to make bequests—assets that may be left to heirs or other beneficiaries, such as a favorite charity, upon death. In the typical annuity program, the household's assets are retained by the insurer and are no longer available for bequest purposes.[4] Not all households have bequest motives—for many retirees, all of their resources will be spent financing their retirement. But for others, bequests are an important objective for retaining assets in retirement.

Current Income Decisions

A good way to understand household decisions about retirement income is to compare the benefits and risks of several income-oriented vehicles in the marketplace today (Table 3).

Table 3. Estimated Current Income from Various Income-Producing Vehicles

Product	Source	Income Yield	Monthly income on $100,000	Percent of 100% J&S Annuity
Bank CDs	bankrate.com 5-year CD average	4.72%	$393	65%
Vanguard GNMA Fund	vanguard.com	5.06%	$422	69%
Vanguard Long-term Investment Grade	vanguard.com	5.92%	$493	81%
AIG 100% J&S fixed annuity	vanguard.com	7.30%	$608	100%

Source: bankrate.com, Vanguard and AIG on vanguard.com; as of June 20, 2006.

[4] Annuities may be paid to a surviving beneficiary. As well, one type of annuity provides a partial lump-sum payment on death, but income levels are correspondingly lower.

Consider a retiree with accumulated life savings of $100,000. One option for the retiree is to invest his entire pool of assets in bank certificates of deposit (CDs). At current national average yields, he could generate an income of $393 per month over the next five years. This income would be government-guaranteed (via the FDIC), and both principal and income would be secure for the next five years. At that time, he would need to "roll over" the maturing CD, and so income could rise—or fall—with then-current rates. As long as he spends income and not capital, his assets will continue to produce an income stream indefinitely for the retiree, his spouse, or other beneficiary.[5]

Another option for the retiree is to invest in a bond mutual fund. Current yields from two Vanguard bond funds vary from $422 to $493 per month. Bond funds typically offer higher yields than bank CDs, but both principal and income fluctuate over time, and the funds are not government-guaranteed. Retirement investors often select a longer-duration bond fund; though the principal value is more volatile, the fund's income stream tends to be higher and more stable. Why would households choose to assume these risks? One reason is that many households have become accustomed to assuming capital market risk during their working years. Moreover, the risks of bond funds are substantially lower than the risks of stock funds assumed by households in their accumulation years. So households appear increasingly willing to take these modest risks in order to achieve a higher level of income. Bond funds also offer daily liquidity and immediate access to savings at then-current prices (which could result in a gain or loss).

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[5] All of the vehicles in our example are also subject to inflation risk. Products to counteract inflation risk, in whole or in part, include: Treasury inflation-protected securities (TIPS), TIPS mutual funds, balanced or lifecycle funds, dividend-paying stocks or stock funds, as well as variable annuities investing in these assets. Here we are not analyzing inflation risk, which affects all fixed-income products, but instead how households are assessing the relative merits of income-producing vehicles and managing longevity risk.

Another option for our retiree is to purchase an income annuity—in our example, a 100% joint and survivor (J&S) annuity offered through Vanguard in association with the insurer AIG. Here the promised income would be $608 per month over the life of the retiree and his spouse.[6] The income is guaranteed for life but, as with the other income alternatives, comes with its own set of risks. One drawback is that, in our example, the retiree's entire life savings are handed over to the insurer. Many consumers balk at allocating a large portion of their savings to a single financial company. There is also a small but important level of credit or default risk associated with investing one's capital in a single insurance contract. Second, none of the $100,000 in savings is available in the event of unplanned expenses in retirement, nor is any available for bequests. Finally, when the annuity is purchased, the income stream is locked in at then-current interest rates for the remainder of the retiree's—and spouse's—lifetime.

This example encapsulates the choices faced daily by households choosing between bank, mutual fund and annuity income products. With bank CDs and bond mutual funds, retirees can generate income that is anywhere from 65% to 80% of the income from an annuity. While these financial products come with certain income and/or principal risks, as well as longevity risk, they also offer flexibility and control in retirement. Retirees can manage these risks by adjusting their spending at the margin, as many do today, and by carefully spending income and not principal. Finally, for most, there is the important backstop of annuity income from Social Security. A private income annuity eliminates longevity risk, but the retiree must forfeit control over a large

[6] In estimating the annuity value, we assumed a 65-year-old male retiree and a 63-year-old female spouse as joint annuitants. We also assumed a 100% joint and survivor annuity to make the annuity income comparable to the CD and bond fund examples, where the surviving spouse would presumably inherit all of the assets and related income.

pool of savings, gives up flexibility in retirement spending and bequests, and locks in income levels at today's rates. And for retirees in poorer health, income annuities appear to too expensive and appear to yield too low an income.

According to research by insurers and fund managers, it is these types of considerations that have prompted many individuals to choose asset-based income over annuities in retirement.

Policies on Retirement Income

What can policymakers do to help in the annuity-income versus asset-income decision? At Vanguard, we anticipate much innovation on this topic in the coming years from insurance companies, banks, and asset management firms. On the annuity side, one intriguing idea is "longevity insurance"—an annuity that pays a benefit only if you live beyond a certain age, such as 85. Such an annuity is much less costly than a traditional income annuity, and so appeals to individuals concerned about giving up control over a large portion of their assets. It also represents the pure longevity insurance component of a traditional annuity. Some tax rule changes would encourage this new type of product.

Over the years, various proposals have been put forth to create tax incentives for the purchase of income annuities. (These incentives would come on top of the tax deferral benefit that all annuities enjoy during the accumulation period.) Policymakers have understandably become more interested in private annuity incentives with the decline of annuity payouts from traditional defined benefit plans and the rise of lump sums from defined contribution plans. Yet, as noted earlier, six out of ten retirees—typically most low- and middle-income households—already receive substantial levels of

annuity income from Social Security. Many in this group are likely to have low levels of taxable income, and so for most any annuity tax benefit would be of limited value. Meanwhile, four in ten retirees rely less on Social Security and would likely benefit from an annuity tax break. Yet these are also typically higher-income and/or asset-rich retirees who are more likely to have the advice, resources and skill to manage retirement risks on their own. It seems harder to justify tax incentives for annuity over asset income based on concerns about economic security among more affluent retirees, especially relative to other tax reform priorities for the U.S. retirement system.

On the asset income side, a topic worth considering is tax simplification broadly. The tax rules governing different types of accounts and plans, as well as the taxation of Social Security, are simply too complex. One positive step would be eliminating the required minimum distribution (RMD) rules, as the Joint Committee on Taxation has recommended.[7] These rules were designed with the Treasury's revenue stream in mind, not as a long-term pay-down or income strategy for individuals. Eliminating the RMD rules would help simplify tax compliance for retirees. It would also assist financial services firms in designing programs that focus on generating a sustainable stream of income, not simply on complying with federal tax rules.

Although tangential to our expertise at Vanguard, another important income issue is translating home equity into an income stream. Eighty percent of older Americans own their own homes. Yet the reverse mortgage market is miniscule and the take-up rate is low. Among the problems that appear to surface in the market are worries about mis-

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[7] Joint Committee on Taxation, 2001. *Study of the Overall State of the Federal Tax System and Recommendations for Simplification, Pursuant to Section 8022(3)(B) of the Internal Revenue Code of 1986* (JCS-3-01). See in particular: *Volume II: Recommendations of the Staff of the Joint Committee on Taxation to Simplify the Federal Tax System,* pp. 194-197.

selling, high transactions costs and the overall complexity of the transaction. Perhaps some federal standardization could help improve the efficiency of the market.

Finally, efforts to encourage financial planning and investment advice make sense—to help individuals choose an appropriate retirement date and to develop retirement income strategies. These include existing proposals to improve advice through qualified plans in the workplace, as well as federal leadership in the creation of a national personal finance curriculum for U.S. high schools. We also take note of the formation a year ago of the Financial and Economic Literacy Caucus in the House of Representatives. That Caucus seeks to improve financial literacy rates across the country and during all stages of life, to provide a forum for interested Members of Congress to promote policies to advance financial literacy and economic education, and to ensure that citizens of all ages and walks of life have access to objective financial education.

Conclusion

The first baby boomers turn 60 in 2006. Given the unique scale of the baby boom cohort, there is a natural tendency to view its retirement challenges as unique and unprecedented. This sense of uniqueness has been one of the generation's defining characteristics.

At the same time, policymakers, researchers, employers, and financial service providers must recognize that millions of retired Americans have been making critical benefit plan and investment and savings choices for years. These include choosing between an annuity or lump sump option in a defined benefit plan, investing a defined contribution plan lump sum, and evaluating the merits of different income vehicles (e.g.,

bank CDs, bond funds, annuities) for their retirement savings. No doubt the number of investment and savings options has increased over the decades. But the elements of sound decision-making—evaluating benefits, risks and costs—remain unchanged.

With the prospective retirement of the baby boom generation, many more Americans will be called upon to make these critical choices. Policymakers can make a special effort to encourage longer periods of work—to ensure that many Americans avoid the risk of retiring too early with inadequate resources. They can take steps that streamline and simplify tax and other rules, allowing insurers, asset managers, and banks to create products and services that help aging baby boomers generate a sustainable income in retirement. And they can foster a national dialogue on the importance of financial literacy. For baby boom retirees, the most effective strategy will lie in choosing to work a few years more, and in selecting the right mix of annuity- and asset-based income that is suitable for their personal circumstances. By making wise choices in these areas, Americans can ensure that they have both financial security and flexibility as they manage their accumulated savings in retirement.

The CHAIRMAN. Thank you very much, Stephen.
Gil, take it away.

STATEMENT OF LEROY GILBERTSON, MEMBER, NATIONAL POLICY COUNCIL, AMERICAN ASSOCIATION OF RETIRED PERSONS, DALLAS, OR

Mr. GILBERTSON. Mr. Chairman, members of the Committee, I am Gil Gilbertson. I am a member of the AARP National Policy Council. I also do some private consulting work for businesses as it relates to their 401(k) plans.

We commend you for convening this hearing on ensuring that retirees manage their assets over an increased life span. Planning for retirement should begin when an individual enters the labor force and it requires a savings discipline and financial astuteness that most people have never encountered before. Many workers retire ill-prepared for the challenge of preserving their assets in the face of a longer than anticipated life span. Even those who have planned well can face unforeseen obstacles.

As a personal note, my parents and grandparents lived to be in their 90's and my wife's grandparents lived into their 90's. So we are an actuarial nightmare for actuaries to try to figure out how long we are going to be living, plus the fact of just moving to Oregon for 6 months out of the year has probably increased our longevity with the clean air and the lifestyle in Oregon.

AARP believes retirement security consists of four pillars: Social Security, pensions and savings, continued earnings, and health care coverage. For the vast majority, Social Security is the solid foundation of a secure retirement that provides a defined benefit which is guaranteed for life and adjusted annually for inflation.

For many of today's retirees, and even more tomorrow, Social Security will be their only defined benefit pension and the only income source that will not require their oversight and management. While Social Security faces a long-term challenge, we can make adjustments that will maintain Social Security's lifetime income for future generations.

In contrast to Social Security, the pensions and savings pillar is much shakier. Over half of private sector workers have no regular payroll mechanism to save for the future and there are challenges for those with a pension.

Defined benefit pensions are declining as the number of firms freezing, terminating or otherwise abandoning their pension obligation rises. Many companies are converting to defined contribution plans that require workers to absorb more risk and responsibility. Defined contribution plans are subject to early withdrawals, poor investment decisions and a failure to annuitize account balances. So even if a worker has contributed to a retirement savings plan, it is likely to provide a much less adequate income in retirement than defined benefit pensions provide.

We need to take steps to strengthen the pension pillar. This can include providing the necessary financial education and quality investment advice, congressional approval of automatic 401(k) features, establishing a regular payroll deduction mechanism for workers to save for retirement, adopting pension reforms that

strengthen the defined benefit system and protect older workers, and extending the Saver's Credit and making it permanent.

The picture for personal savings and investment is even grimmer than for pensions. Despite being among the wealthiest groups, the over-age–50 cohort is not saving adequately for a retirement that could span three decades. Moreover, many in this group are going deeper into personal debt.

In order to encourage responsible savings and investment behavior among those age 50 and over, AARP has established five principles. They are: using indexed funds, keeping the fees low in those funds, diversifying investments, rebalancing to stay on track, and finally just keep it simple. AARP is working to empower those aged 50 and over to attain a secure financial future and to safeguard their assets. AARP has conducted educational programs in financial literacy and prudent investment strategies.

The third pillar of secure retirement, earnings, is a growing source of income. For many, the decision to continue working is an economic one. Additional income and health care coverage are becoming more and more important as years go by. While many may want to work, the job market is difficult for those without recent training and current skills, and age discrimination is still prevalent in the workplace.

While policymakers are encouraging later retirement through changes such as raising the age for collecting full Social Security benefits, many employers are not providing workplace accommodations, such as phased retirement or flexible work schedules, that would help recruit and retain older employees.

The final pillar, health care coverage, is vital. Closely associated with overall health care coverage is protection against long-term care costs. We must do a better job of making long-term care more accessible, affordable and understandable.

Mr. Chairman and members of the Committee, we have painted a detailed landscape of retirement so that we can better deal with the challenges that boomers and future retirees will face. There is much that can and should be done to make management of retirement assets easier. Although times have changed, Social Security remains the No. 1 pillar of retirement that provides a lifetime, inflation-adjusted income stream.

I thank you for the opportunity to present AARP's views, and I would be willing to answer any questions. Thank you, Mr. Chairman.

[The prepared statement of Mr. Gilbertson follows:]

AARP

TESTIMONY BEFORE THE

SENATE SPECIAL COMMITTEE ON AGING

ON

Managing Retirement Assets

June 21, 2006

WASHINGTON, D.C.

WITNESS: Mr. Leroy Gilbertson
Member, National Policy Council

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Mr. Chairman and members of the Committee, I am Leroy Gilbertson, a member of AARP's National Policy Council. Thank you for convening this hearing to explore the issues facing Americans when managing their assets in retirement.

While many of AARP's members are retired, many others are part of the 76 million boomers who are moving into retirement. Generally they will be in better financial and physical health than prior generations of retirees, and research indicates they will live longer in retirement. This hearing will give us an opportunity to examine how we can ensure that boomers do not outlive their retirement assets. It is important to note, however, that while boomers "on average" will be better off in retirement than previous generations, the distribution of income and wealth among them may be more unequal than in earlier years. In other words, there will be a relatively large number of retirees with very few assets to manage or on which to rely.

AARP is a nonprofit, nonpartisan membership organization that helps people 50+ have independence, choice and control in ways that are beneficial and affordable to them and society as a whole. We produce AARP The Magazine, AARP Bulletin, AARP Segunda Juventud, NRTA Live & Learn, and provide information via our website, www.aarp.org. AARP publications reach more households than any other publication in the United States. The AARP Foundation provides security, protection, and empowerment to older persons in need with support

from thousands of volunteers, donors, and sponsors. We have staffed offices in all 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands.

AARP advocates for policies that enhance and protect the economic security of individuals as they move from work to retirement. Advocacy is not limited to Social Security, pensions or retirement plans; it extends to investment literacy, health and long-term care issues, work, and other areas that affect the financial well-being of our members. If AARP members have the basic tools to manage their assets successfully before and after retirement, they will be more likely to maintain at least an adequate standard of living throughout their retirement.

Planning for retirement is a complicated process that should begin when an individual enters the workforce. Reaching and maintaining the goal of a comfortable lifestyle for what could be three decades of retirement requires consistent effort and discipline over a worker's career and also in retirement. In addition, there are many unforeseen challenges to successful planning, such as unexpected health care costs, periods of unemployment and disability, or sustained periods of inflation, that make it difficult for many to leave the work world financially prepared for a long retirement.

For the most part, the boomers have prepared for a retirement similar to that of their parents and older relatives. In particular, they have not anticipated or tend to underestimate the gains in life expectancy that have been underway during

their work careers. The life expectancy for the fathers of boomers who reached age 65 in 1990 was 15.7 years. The projected life expectancy for boomer men reaching age 65 in 2015 is 17.7 years. As a result, a substantial number of boomers are in danger of outliving their assets because they underestimate how long they will live in retirement.

I Retirement Assets

Currently, most Americans' retirement security comes from several sources of income. For the vast majority, Social Security is the foundation of economic security in retirement. Social Security, however, is only part of the overall retirement security structure. A secure retirement is supported by four pillars: (1) Social Security, (2) Pensions and savings, (3) Continued earnings, and (4) Adequate and affordable health insurance. In that context, the importance of Social Security is evident as each of the other pillars faces mounting pressures.

A. Social Security. Social Security is the base of retirement -- representing the only guaranteed defined benefit income most workers will have-- and it is the one pillar of retirement security that does not present challenges to workers at retirement. Social Security is the primary source of retirement benefits for most Americans. It provides a progressive, inflation-adjusted lifetime benefit to all individuals who qualify. Consequently, it has dramatically improved the economic status of older Americans over the past decades.

Social Security is essential to the financial well being of most retirees. According to the Social Security Administration (SSA), nearly two-thirds of beneficiaries derive more than half of their income from Social Security, and for 21 percent of beneficiaries, Social Security represents all of their retirement income. Social Security is more than a retirement program; it is income insurance, providing benefits to workers who become disabled; to families when a wage earner dies or becomes disabled; to widows(ers) age 60 and over; to widows(ers) aged 50 and over with disabilities; as well as to retired workers, their spouses and their families.

SSA data show that 96 percent of all workers are covered by Social Security. More than 33 million people receive retirement benefits. According to January 2006 figures, the average monthly benefit for a retired worker is $963; for a couple where both are beneficiaries the average benefit is $1583; and for a widow(ers) alone the average monthly amount is $929.

Although it has been around for over 7 decades, many younger workers are concerned about the future of Social Security and whether it will be there when they retire. While Social Security will require some adjustments, the system is now projected to be able to pay full benefits until 2040, and over 70 percent of benefits for several decades after that. If adjustments are made sooner rather than later, the changes can be more modest, and it will allow those affected more time to adapt their financial plans.

AARP believes that any solvency package should maintain Social Security as a stable and progressive defined benefit program that provides guaranteed lifetime inflation protected benefits to all who have contributed to the system and meet the qualifications.

B. Pensions

Less than fifty percent of working Americans have a pension plan available through their workplace, and half of all private sector workers have no regular payroll deduction mechanism to save for their future. As of 2001, the latest data released by the Department of Labor, 22 million workers actively participated in defined benefit plans. Defined benefit plan participants tend to work in large, older firms, and belong to labor unions.

Participation in defined benefit plans varies by age, with 37 percent of workers ages 43 to 52 participating in 1998, versus 15 percent of workers ages 16 to 32. Participation also varies by workers' earnings, 18 percent of workers earning $30,000 or less participated in a defined benefit plan in 1998, versus 40 percent of workers earning more than $30,000.

Today, traditional defined benefit plans are disappearing. The number of firms freezing, terminating, or otherwise abandoning their pension obligations is increasing. A large number of boomers are losing the benefit of their long years

of service and their peak earning years (including any early retirement subsidies) that would maximize their pension benefits. These employees may have made career and retirement decisions based upon the expectation of a certain pension benefit, only to see that expectation disappear – replaced by a defined contribution or cash balance plan under which their age precludes them from earning comparable benefits.

Many companies that do offer pensions are converting to defined contribution plans and workers are absorbing more risk and responsibility for their retirement security. Frequently, workers are ill-equipped to handle this new role, especially those with limited exposure to financial products. Defined contribution plans expose workers to significant investment and longevity risk and their potential role in delivering retirement security is weakened by early withdrawals, low contribution rates, high costs, unsuccessful investment decisions, and failure to annuitize any portion of the account balance upon retirement. So, even if a worker has contributed to a retirement savings plan, it may provide a much less adequate retirement income level than a defined benefit plan.

We need to take the steps necessary to deal with these trends and strengthen the retirement pillar linked to pensions. This could include

- Providing the financial education necessary to make prudent decisions about savings and investing in the work place since workers have an increased responsibly for accumulating and managing retirement assets.

- Congressional approval of features of an automatic 401(k).
- Providing quality, independent investment advice to workers.
- Establishing a regular payroll deduction mechanism for all workers to save for their future.
- Better diversification, especially for plans with heavy concentrations of employer stock.
- Adopting pension reform legislation that strengthens the defined benefit pension system and the Pension Benefit Guaranty Corporation while protecting the benefits of older workers.
- Expanding the Savers Credit and making it permanent.

The focus of our attention with regard to defined contribution plans has been on encouraging individuals to accumulate sufficient assets to finance a secure retirement. Since many new retirees can expect to live for almost two decades in retirement and many will spend three or more decades in retirement, the challenge will be to find solutions that enable them to manage their assets for a longer time period.

AARP has long recognized the importance of a guaranteed stream of income throughout retirement. We have and will continue to support proposals that would encourage individuals to select an annuity rather than to cash out a lump sum distribution from either a defined benefit or a defined contribution plan. We

also favor new incentives that would encourage 401(k) sponsors to automatically provide plan participants with an annuity option.

We are also carefully considering and evaluating the potential impact of the proposals to provide new tax incentives to encourage individuals to use annuities to insure against longevity risk.

AARP has been concerned with the high fees, complexities, and marketing practices associated with certain annuity products. We want to work with others to foster products and incentives that will help individuals manage their assets and ensure their financial security in retirement. In addition, we want to assist our members to become wise consumers.

C. Personal Savings and Investments. While the 50+ age group is still the country's wealthiest cohort, with higher rates of home ownership and savings than younger groups, many of them are ill prepared for retirement. Nationwide personal savings are at an all time low, and many of the retirement savers age 50 and older have accumulated far less than they will need for a retirement that could be three decades or longer. And, a mere six percent of individuals contribute to an IRA or a Roth IRA.

Unfortunately, many in the age 50 and older group are going deeper into personal debt and also will not own their homes free and clear as their parents

did when they retired. In the 1990's, the median amount of money older people owed doubled in every income bracket, and the burden is highest among individuals with low-incomes. The circumstances of the age 55-64 cohort of pre-retirees are especially worrisome because, on the one hand, they carry the most debt and on the other, they are nearing traditional retirement age and do not have the resources to fully retire. Unfortunately, many in this age group may not know they cannot afford to retire until it is too late.

In order to encourage responsible savings and investment among those 50 and over, AARP has established five principles to guide these choices. If these time-tested investment principles are followed, a strong foundation of financial security will be established. The five principles are

→ Keep fees low

→ Use index funds

→ Diversify investments

→ Rebalance to stay on track

→ Keep it simple

→ **Keep Fees Low**

Fees and expenses limit returns over time, which, in turn, reduce the amount of retirement savings accumulated. Since fees occur in all types of financial products-- mutual funds, individual stocks and bonds, insurance vehicles, and

mortgages-- individuals should scrutinize financial documents for clearly stated, as well as hidden, fees.

When it comes to mutual funds, it is important to know the difference between “load” and “no load” products. In order to maximize asset accumulation, look for no-load funds with expense ratios of less than 1 percent. Similarly, when it comes to trading individual stocks or bonds, find ways to keep costs low.

Here are examples of how fees can impact performance:

What the fees cost you on an initial $10,000 investment	**Pay these fees for a low-cost fund (0.50%)**	**Pay these fees for a mid-cost fund (1.25%)**	**The low-cost fund saves you...**
10 years	$796	$1,925	$1,129
20 years	$2,531	$5,902	$3,371
30 years	$6,034	$13,585	$7,551

→ **Use Index Funds**

Investment research shows that mutual fund managers who try to buy and sell individual companies based on their own research have difficulty outperforming the broader markets over time. That is why index funds are so attractive. Index

funds offer a broad range of benefits including simplicity, lower costs, diversification, matching the market, and tax advantages.

→ **Diversify to Reduce Risk**

Diversification means spreading investments among different asset classes, and having exposure to a large number of different companies. It is difficult to tell with certainty which investments will rise in price; yet, when individuals diversify their portfolios they improve their chances of owning investments that will increase in value. Just as important, however, a diversified portfolio helps lessen the impact of investments that lose value.

→ **Rebalance to Stay on Track**

Once investment decisions have been made, many investors do not revisit those choices. Yet, markets change. Rebalancing helps maintain target asset allocation among stocks, bonds and cash, and avoids exposing workers and retirees to inappropriate risk. Some funds are regularly rebalanced to help them maintain their diversification and control risk, which may be especially helpful to individuals who are less comfortable managing their assets.

→ **Keep it Simple**

Since there are over 10,000 mutual funds in the United States, it is important for investors of any age to determine which fund is right for their financial situation. Having too many choices can be overwhelming, making it difficult to manage risk,

ensure proper diversification, and be confident that all their investments are working toward a common goal.

As part of AARP's continued efforts to empower those age 50 and over to have a secure financial future and safeguard their assets, we have conducted seminars, consumer universities, and other educational programs on financial literacy and investment strategies. Many more are planned as we help our members to become financially literate and be smarter investors and consumers of financial products.

D. Earnings/work. Earnings are becoming a growing source of household income in old age. According to SSA, earnings accounted for nearly 25 percent of the aggregate income of aged 65+ units in 2002, up from under 21 percent in 1998. Many signs point to further increases in the need for earnings during the "retirement" years, especially since nearly 80 percent of boomers in an AARP survey say they expect to work in retirement.

For older workers, the decision about whether and when to retire is important. For many, the decision to continue working is an economic one: additional income and/or health care coverage. Returning to the workforce after a period of time is not always easy for older workers. Skills may be out of date and age discrimination is a serious problem. These workers tend to be unemployed

longer, are less likely to become reemployed, and are more likely to experience earnings and benefit losses if they do find work.

At what age boomer's choose to retire will have a considerable impact on the labor force. In recent years, policymakers have encouraged later retirement by gradually raising the age for full Social Security benefits, eliminating the earnings test for working Social Security beneficiaries who are at the full retirement age, and by increasing the delayed retirement credit for those who postpone collecting benefits until age 70. Policies governing employment, retirement, and income taxation could foster longer labor force participation and protect the rights of those age 50+ workers who choose to stay on the job.

AARP supports the development and implementation of work options, including phased retirement programs, that would expand employment opportunities for age 50+ men and women who must and/or want to work. We are helping create solutions to meet the needs of the workforce and age 50+ employees through research, information, advocacy, and training programs. For their part, workers must be educated about what they need to do to remain employable.

From a public policy perspective, a number of initiatives would help keep older workers in the labor force. These include eliminating barriers to phased retirement programs, vigorous enforcement of employment discrimination laws,

increased attention to the training and employment needs of vulnerable groups, and an older worker-friendly and better-funded job training system.

D. Health Coverage. Maintaining health care coverage is important to those in the labor force as well as those who are in retirement. Without adequate health coverage, a major health problem can seriously erode or even wipe out savings at a time when replacing any lost income may be difficult or impossible.

The decline in the share of employers offering retiree health benefits in recent years is a matter of increasing concern. Between 1993 and 2004, the percentage of large employers offering health benefits dropped from 46 percent to 28 percent for retirees under age 65 and from 40 percent to 20 percent for Medicare-eligible retirees. Even those who have employer-sponsored health benefits face higher costs because employers pass an increasing portion of rising health care costs to retirees. Retirees also face changes in coverage, such as increased cost-sharing or caps on employer contributions. If the price of retiree health benefits grows beyond the reach of retirees, they may lose coverage and become vulnerable to the risk of major out-of-pocket health costs particularly if they become seriously ill.

AARP supports and strongly encourages incentives for employers to maintain and safeguard retirement health benefits. Most recently we supported the

employer incentives included in the Medicare Modernization Act of 2003. Policies affecting retirement health benefits should incorporate features that prevent deterioration of health benefits. AARP also believes the time is right for Congress to reignite the debate over health systems reform so that we can begin to control rapidly rising health care costs and make affordable health care coverage available to all Americans.

Closely associated with overall healthcare coverage is protection against long-term care costs. Long-term care is a critical element of retirement planning that is often overlooked. AARP members have indicated that there is a great deal of resistance to thinking about long-term care. This may be because individuals have misperceptions about long-term care: they may believe it is limited to nursing home care; are often under the mistaken impression that Medicare will cover long-term care; or are in denial about the likelihood they will require future services. Yet, men turning 65 face a 44 percent chance of needing help with at least two activities of daily living for at least three months or more. For women turning 65, the percentage is much higher--72 percent.

However, current long-term care financing options are limited; they are often too expensive and too complex. That's why Americans need more and better options to plan and pay for long-term care. For example, long-term care insurance should be more affordable, accessible, and have strong consumer protection standards. Improved tools to compare policies would also be helpful.

In addition, consumer education on long-term care is vital. Americans should understand the likelihood of needing long-term services and support; the types, cost and availability of services; the options available to help plan and pay for services; why it is their interest to plan; and where to go for further information and assistance.

III. Conclusion

Planning for and managing resources in retirement is difficult enough, but it has become much more complicated over the years as we move towards a “do it yourself” retirement. New retirees will need a more sophisticated knowledge of investment options and ways to preserve assets through retirement. Gone are the days when boomers’ grandparents retired with Social Security, a company pension, savings in the bank, and a paid-off house. There is much that can and should be done to make accumulating and managing retirement assets easier and more secure for workers and retirees. And, although times have changed, Social Security remains the critical and basic pillar of lifetime retirement income and more than ever the only one that can be counted on to provide a lifetime income stream.

The CHAIRMAN. Thank you, Gil. Oregon once had a Governor, Tom McCall, who famously said, "Please visit, but do not stay." It seems you have accepted half of his advice. You stay 6 months a year. You indicate that you think your longevity is on the increase because of that.

I wonder, have you calculated how long you might live if you stayed 12 months a year?

Mr. GILBERTSON. Well, I haven't, but I probably would be close to 100 years old.

The CHAIRMAN. I want to ask you about one of the pillars you talked about and that is seniors working longer. It is the policy of the AARP to encourage seniors to work longer. Is that correct?

Mr. GILBERTSON. That is correct, yes.

The CHAIRMAN. If they choose to?

Mr. GILBERTSON. If they choose to.

The CHAIRMAN. There are significant impediments to employing seniors, I think you have pointed out in your testimony. Are there pieces of legislation that you would have us pursue to encourage employers to provide longevity of employment to seniors on a more flextime basis?

Mr. GILBERTSON. Yes. AARP is constantly studying the issues. As a matter of fact, a committee that I sit on within AARP's National Policy Council this summer will be studying exactly that issue as it relates to employment of those who are 50 and older.

We are probably going to end up making recommendations to the board as it relates to strengthening those kinds of issues, plus I would suspect coming out of that would be ideas and suggestions for legislation that would also strengthen that.

The CHAIRMAN. Well, we would very much like to have your recommendations on that because I think one of the answers, frankly, to the American economy is encouraging people to work longer and giving them the flexibility. Obviously, it is one of the keys that you have identified as helping seniors to have the money they need to continue to live.

Mr. GILBERTSON. Yes.

The CHAIRMAN. Ben, you mentioned that the average senior in America has $50,000 of liquidity. Is that correct? Did I hear that correctly?

Mr. STEIN. That is what I am told by people in a position to know. That is a rough number; it is a very rough number.

The CHAIRMAN. Obviously, the answer to how much do you need in retirement varies with every individual, but have you heard of any number that seniors ought to be working for?

Mr. STEIN. Well, the number that I always use in my calculations is to take what you were earning the last year before you retired, subtract from that the amount that you are saving, and then multiply that by roughly 15 and that is the approximate amount you should have. That would be a minimum amount. If you are going to use my colleague's suggestion that you only withdraw 4 percent of your savings a year, you would need more like 20-plus times that amount. I think 4 percent a year might be a tiny bit conservative, but you need a heck of a lot is the short answer, and very few people have it.

When you tell a person who earns $100,000 or $200,000 a year that he or she needs 15 or 20 times that amount to retire, that person gets pretty worried. Then when you say you are better if you have 22 or 23 times that amount to allow for inflation and to allow for some of the money to keep compounding and growing to offset inflation instead of paying it all out to yourself as you live out your life, people get really scared. You need an awful lot of money.

We have many, many deficits in this country. We have enormous Medicare deficit, an enormous budget deficit, an enormous trade deficit. We also unfortunately have a very, very large deficit of what the baby-boomer generation should have saved compared to what it has saved, and that number is in the trillions of dollars. I once calculated that as being on the order of $15 trillion that we are short in savings. That is, to me, a lot of money.

The CHAIRMAN. The multiple of 15 is the number of years that one could be expected to——

Mr. STEIN. No, no. That is to account for the amount of income you would be likely to earn, counting dividends plus capital gains on the amount of money you have saved. It is an awful lot of money and very few people are doing it, and if they did more of it, we would be a happier group of people.

The CHAIRMAN. With your economist hat on, if there is one piece of advice you would give to every baby-boomer, what would it be?

Mr. STEIN. Save until it hurts, and if it is not hurting, you are not saving enough. You know, if you are partner at Goldman Sachs——

The CHAIRMAN. You are going to be OK.

Mr. STEIN [continuing]. You will probably be OK. But for most people, they have to save a painfully large amount. I mean, the vicissitudes of retirement are scary and if you are retiring on enough to live on when you are 65 and prices double by the time you are 88, you are going to be a very sad puppy if you haven't saved enough.

Mr. UTKUS. Senator, if I could make a comment on that?

The CHAIRMAN. Yes, please.

Mr. UTKUS. I do think that the examples that Ben cites are perhaps not the appropriate ones, just given that the median household income is somewhere in the $40,000-a-year range rather than at $100,000 or $200,000.

I am least concerned about the ability of six-figure families to save for retirement, and if they tell me that they are not saving enough and they are going to have to live on $50,000 a year, I am going to tell them they are going to be richer than 80 percent of retirees in America today.

So I think if you look at the reality of retirement today—let's forget about the baby boom—30 percent of households rely virtually exclusively on Social Security or supplemental security income and other sort of public benefits. So three out of ten households today have never saved in the past, and we see similar results today of workers. Three out of ten have less than $10,000 a year as they approach retirement.

So I think it is important not to be too catastrophic about this because today millions of Americans are retired and three out of ten of them have no money but Social Security and very little in

work earnings. That is the state of the world today. Then in the middle, there are 30 percent who rely on Social Security for over half of their income. So that is a pretty strong backstop for retirement security.

Then there is the 40 percent who don't rely on Social Security as their dominant income source, but I don't know that they should be the appropriate focus of policymakers because they are the people with 90 percent of the assets.

The CHAIRMAN. Mr. Henrikson, the same question to you as to Ben Stein. If there was one piece of advice, I assume you would say take advantage of the pooling of risk and buy an annuity. Would that be your advice?

Mr. HENRIKSON. Well, that could be an answer, but I think as you yourself, Senator Smith, said, if I recall, in your opening comments, one of the No. 1 priorities is knowledge, knowledge about this issue, and then within that what the power of a mortality pool is.

So I am not suggesting that everybody rush out and buy an annuity, but what I am saying is that, as pointed out in terms of the conversation, we know that individuals may be more educated than they have been in the past, but they are not facile in terms of making asset allocation decisions with a pot of money to generate an income for the rest of their life.

As was pointed out, you can make income last for the rest of your life if you don't touch the principle. The people we are talking about don't have that luxury. Maybe the Goldman Sachs partner can live off of clipping coupons and then leave as a legacy to their family or whomever the principle that they didn't spend. But most people are going to have a different kind of a legacy to deal with, and I think the legacy that parents can leave to their children that they are more independent because they have an income will be extremely important.

I think the issue is what kind of an income do they need. Beyond that income, they can do other things with their assets that may turn out to be disastrous or may turn out to be homeruns.

I just would say one other thing. Most people in the United States—I believe this is true—99.44 percent, including high-income people, tend to make decisions about their life, about where they live, where their kids go to school, what kinds of vacations they take, when they go out to eat, and so forth and so on, based on their income. They don't base it on a bag of cash, nor do they base it on the present value of their future income.

So if you ask somebody what is your job worth, they are liable to say something like, well, what does that mean? If they think about it long enough, they will say, well, I am paid $50,000 a year, $40,000 a year or $100,000 a year, whatever the number might be. They don't say the present value of my future income is "X," and that is what we are asking them to do with this bag of cash. That is the present value of something and they don't know what that something is. So that is really what the education has to be about.

The CHAIRMAN. With the indulgence of my colleagues, I wonder if I can ask Ben to put your economist hat on and speak to the larger question that Robert just hit on, what is there in the American psychology that unlike many European countries, unlike

China and Japan, we don't save. Is it just a consumer mentality that has driven us all these years?

Mr. STEIN. Well, if you think of it from a psychologist's perspective, it is a very interesting thing. If you slap down a little plastic card, you can get a big-screen TV or a trip to the Bahamas or a trip to Oregon. If you take the same amount of money and put it in an account at Fidelity, the next thing you know it is gone. It is not really gone, but it seems like it is gone. It is not available. You can't watch "The Ladies of Wisteria Lane" on it. You can't get a suntan in it, so it seems to be gone. That is the way a child would approach it, and unfortunately we have a kind of childish mentality among a great many—by no means all—U.S. citizens.

There is also another problem. Interestingly enough, savings rates tend to be higher during bad economic times than during good economic times because people get scared and concerned about their futures and they save more. In China, the ordinary citizen with an income of something like one-fifteenth that of the U.S., maybe less than that, saves roughly 40 percent of his or her income. In this country, which has a very, very large average income, we save on the average of a negative amount.

So uncertainty, fear, civil war, privation, dictatorship, depression make people want to save in this country. Where happy times are here again and have been for a very long time, not for everyone, but for a great many people, people don't tend to save. This is a happy country, and this is a happy country with a very, among all too many people, kind of juvenile mind set. That is not obviously true of everyone, but it is not a mature mind set to not save.

The CHAIRMAN. But you wouldn't be pushing us to adopt policies that brought about plagues and pestilence and depressions?

Mr. STEIN. Well, no, I wouldn't be pushing you to do it all this summer.

The CHAIRMAN. Thank you.

Senator Kohl.

Senator KOHL. Thank you very much. Two things, to me, stand out as we listen to what you have said and, of course, think about all the accumulated knowledge that we have in this area. One thing is to be certain beyond question that Social Security remains really, strong and a foundation and a pillar of people's ability to live out their retirement years. I would like your comment on that, particularly in light of some of the efforts that have gone on here to change the nature of Social Security.

The second thing is, isn't it true that if we were successful in having a society that offered the kinds of incentives and inducements to keep people working longer which you have alluded to—if we could accomplish those two things, it would change the nature and the dilemma and the difficulty that we are looking at with respect to our emerging retirement population and how they are going to manage to survive into the future?

If Social Security becomes bedrock and people do manage to work into their 70's, given the fact that they are healthier than they have ever been before and have a longer life expectancy, don't we need to look at all this from a different point of view, Mr. Gilbertson?

Mr. GILBERTSON. Yes. Of course, AARP strongly believes in Social Security as the very foundation of retirement plan and keeping Social Security in a healthy situation, because as many on the panel have pointed out, Social Security in the future is still going to be an important part of anyone's retirement plan.

Now, regarding people working when they get older, we feel, that people should be able to work if they choose to. There is a differentiation between having to work and choosing to work. If we can reach a happy medium where we can get people to save so that they will understand and have a good retirement system and then choose to work beyond it, it may be an idealistic situation, but I think it is a worthy goal to be working toward.

I managed a very large pension system before I retired and people would come in and get an estimate of what their pensions were going to be, and then our benefit counselors would say, "Have you thought about health insurance." Those that were under 65, of course, and were not eligible for Medicare? Calculated what the health insurance would cost them, they would say, "Well, I guess I had better go home and tear up that resignation letter because this is just not going to work." The health insurance part could eat up a big portion of what their pension is. So I think we have to have a discussion as it relates to a lot of different issues as to people working beyond their normal retirement age or when they want to retire.

Mr. UTKUS. Senator Kohl, I do think that if you think carefully about encouraging Americans to work more, a lot of the doom and gloom lifts. In other words, there is the sense in which everyone thinks it was pre-ordained sometime by Bismark, but maybe by the post-World War II generation that retirement somewhere between 62 and 65 was written in stone. But, of course, we all know that when Bismark created that rule, most people were dead by 65 and only a few annuitants lived beyond that age.

So I think this whole notion of getting people to work later is to be applauded and I think there are many things that can be done on the benefits side to encourage that. It solves much of the retirement insecurity problem that we are worried about, not in individual cases. Obviously, in individual cases people have health problems and they have financial problems. But as a macro level, as you look at the whole economy, as you do as Senators, it solves a major portion of the concern that we may have.

Then on the question of Social Security, I just think as you think about issues of retirement income support and the split between annuities and asset income, you must think about Social Security as a huge public benefit that, if you will think about it, in effect drives out the need for private annuities for many households.

As I said, 30 percent have 90 percent of their income coming from Social Security. They need more assets, not more income. Another 30 percent have between 50 and 90 percent of their income from Social Security. You might debate some of them need perhaps a little bit more annuitization; maybe some don't. Then the upper 40 percent—well, they have all the money, so I am not really worried as much about them from an annuitization point of view. To me, the decision for them should be neutral. So I think that can help inform this decision about how you set policy in other areas.

Senator KOHL. Mr. Henrikson.

Mr. HENRIKSON. Yes. Well, starting off with Social Security, one of the things Stephen said in his remarks early on was that he mentioned that Social Security was extremely efficient. One of the things that makes it efficient is the fact that it has a mortality pool that it is part of, and without the mortality pool it would not be efficient. So the only comment I would make in terms of a discussion about Social Security going forward is I think it is very, very important to keep Social Security strong in discussions about private accounts, which in and of itself is not necessarily a bad thing.

You cannot remove the mortality pool issues in Social Security and have it be an efficient system. So, for example, if you have a private account, as opposed to income, and you know what that account is and that account is something that you believe when you pass away you bequeath to your heirs, you have taken what we in the industry would call mortality gains out of the Social Security system. Believe me, it would not be efficient. There is no way there is enough money to replicate what mortality gains to the system provide.

So that is the basis of what Social Security is about. We can as a society talk about what the liability will look like going forward in terms of how much it escalates in the future, what age people retire, and so forth. But that is the key principle that we would always, always remind people. There is a mortality pool there. If you break that mortality pool, it will not be an efficient system.

Despite the fact that it sounds good for people to say wouldn't you like to have your account, wouldn't you like to manage it, wouldn't you like to leave it to your children, that is a different paradigm. That is called a 401(k) plan, and I would not suggest turning Social Security into a 401(k) plan, for many, many reasons.

About working longer—and I realize this is not what anyone is suggesting, but I would say the first thing that comes to mind is I think Social Security was put in in the first place because before that people had to work until they dropped dead because they didn't have any source of income.

So the idea about people working longer and encouraging them is absolutely the right thing to do, but there is a limit, and the need in terms of the people who actually need to work longer versus want to work longer is strangely skewed toward the very high-income people that we say that we are not really focused on. So the people who must work in that instance are the people who are lower-income who cannot afford to retire, and the people that want to work, many of them, do all kinds of things.

They may decide to go into the government after they retire. They may decide to go from government into private industry once they retire. They have got a lot of things on their plate. I don't think we are worried about them, but I would worry about suggesting that the person who lives on a $40,000-a-year income need not do anything else. The question to ask them is, if $40,000 is OK, is $50,000 better, would $60,000 be better, and plan around the needs of what those incomes are. So that would be my comment there.

Senator KOHL. Mr. Stein.

Mr. STEIN. Well, as to the merits of working longer, I think the clear answer is it is better to work longer both in terms of your physical and mental alertness, unless you are working in a particularly strenuous job like coal mining. There is an acute labor shortage in this country for clerical jobs, and I think older people are ideally suited to work at those jobs and it is ideal for the employers and it is ideal for them. They feel better about themselves. Their days are organized. They have higher self-esteem. It is a very great benefit to work longer, and I must say people are, in a word, happier if they are working longer.

I am a little puzzled about one of my colleague's comments because the data I have seen indicates that Social Security only replaces about 40 percent of the average retiree's income. As I revolve in my mind data I have recently seen from the American Enterprise Institute about how much Social Security is paid, that seems to be approximately correct.

Where is the rest going to come from? At least some of it has got to come from a guaranteed source if you are going to be prudent. Prudence, it seems to me, dictates that if your employer is kicking you out of the defined benefit plan, you rejoin the pool, and you can rejoin the pool by buying annuities.

I don't in any sense recommend that people do it carelessly. I recommend they shop very, very carefully and only buy the services they need, but it is a good idea to be in a big, giant mortality pool such as can be provided by a gigantic insurance company. Again, shop carefully, ask all the right questions. But Social Security is not going to do it, except for the lowest-income Americans, and another guaranteed source of lifetime income is desirable.

Senator KOHL. Thank you, gentlemen.

Mr. UTKUS. Ben, those statistics are from Social Security, just by the way. So the fact is today 30 percent of Americans get 90 percent of their income—it might not be enough, but it is all coming from Social Security. So this is what people actually have versus what they might replace. That is where those numbers are.

Mr. HENRIKSON. Mr. Chairman, if I might, one other point that was brought up earlier. I would be remiss in terms of the plan sponsor community and their interests in their employees going forward—the question was asked about people being encouraged to work longer. It would be helpful if the pension laws were such that it doesn't put an employee in a position to say, "Well, if I retire, I can get my pension benefit at this employer; if I continue to work, I can't, so what I will do is retire and go to work for my competitor."

So the plan sponsor community—certainly, in the years that I have worked with them, employers are working very, very hard to solve this problem. They want to do the best thing for their employees and this would be helpful in terms of having people be able to work where they are perhaps part-time and not sacrifice the pension benefit to do so.

The CHAIRMAN. We are working on that. We need to fix that.

Senator Carper, of Delaware.

Senator CARPER. Thanks, Mr. Chairman, Senator Kohl, and to our guests, our witnesses, thanks for being here. It is good to see

you and we appreciate very much your testimony and you willingness to respond to our questions.

I used to be State treasurer in one of my earlier incarnations and I was responsible for administering our State's retirement program for State employees. We wanted to encourage our employees to put money into a deferred compensation plan, and we had a variety of investment options there and we found discouragingly low participation among lower-compensated State employees. Those people who were generally in the top quartile of income in the State employee ranks found out about the program and they found ways in many cases to defer a portion of their income for their retirement.

A smarter State treasurer than me came along and came up with an idea to incentivize folks to participate in these plans by giving them all a little bit of money to seed their accounts. If you happened to be a higher-compensated State employee, it didn't really amount to much, but if you happened to be someone who could only put maybe $20 or $30 a month into an account—you know, you give them a couple of bucks and it is an immediate, real return on their investment.

The other thing we figured out is if people have the option of opting in to participate in a plan like that, a lot of times they don't. Even people that ought to who could don't. But if we had a sort of an opt-out requirement—and you may have already gotten into this—if there is an opt-out requirement, people a lot of times will get in and there is sort of a reluctance to get out. It is a very positive thing.

Let me just ask your comments sort of with respect to opt-in and opt-out and how do we incentivize, and maybe some ideas that you are familiar with incentivizing particularly lower-compensated workers to participate in plans like this. Mr. Gilbertson, first, and we will just——

Mr. GILBERTSON. Yes, I can speak a little bit to it. As I indicated earlier, I do some consulting for firms with a 401(k) program and one of the firms is very progressive because they put in automatic enrollment and you can then opt out of it. But they are finding that once they do the automatic enrollment, the employees have a tendency to stay in it.

I think that is a tremendous step forward, whether you go into a 401(k) or a 457 plan, which I am assuming that is what you are talking about as far as deferred compensation on a State level.

Senator CARPER. Yes.

Mr. GILBERTSON. It is something to get them started, and once they see that that money is earning something for them and is growing, then they are a little bit more incentivized to do it. I think it is an excellent idea, and like I say, I think more and more businesses should look at that aspect of it.

Senator CARPER. Thank you, thanks.

Mr. Utkus.

Mr. UTKUS. Senator Carper, the——

Senator CARPER. Let me ask, Steve—I asked the folks sitting behind me, I said, "Does he pronounce his name Utkus or Utkus," and they were equally divided.

Mr. UTKUS. Oh, OK. I say Dick Butkus, no "B."

Senator CARPER. Well, that is good. Thank you.

Mr. UTKUS. You know, there is a great deal of innovation in the 401(k) world and there is a lot of interest in promoting these automatic enrollment plans. In the current conference committee, there are some provisions which we hope will survive to the final bill that encourage this within the defined contribution system.

I should say there are two parts of this. One is among plans that are offered, you want to encourage this trend toward automatic enrollment. I think Congress is taking some important steps there. But the second part is those particularly lower-wage workers at firms that offer no plan at all, and so there are some interesting ideas floating around.

For example, Brookings and Heritage just had an interesting proposal on automatic payroll deduction IRAs in the workplace. The Pension Rights Center is working on a conversation on coverage with financial institutions, organizations like AARP and others, to develop ideas around pension coverage among small businesses. So it is really a two-part problem, but I certainly think anything we can do to encourage more automatic decisionmaking is something we should certainly promote.

Senator CARPER. Thank you.

Mr. Henrikson.

Mr. HENRIKSON. A couple of comments there, Senator. One of the things in terms of basically giving some money to people to encourage them to be part of a plan—in the 401(k) world forever it seems that has been part of the package; in other words, matching contributions. We all know that one of the real tragedies in the 401(k) world in the employer space is that there are so many low-paid people who do not enter the plan, despite the fact it is matched, which, of course, if I do my math right, tells me you get 100 percent return right out of the box.

So the issue here is that the plans in that instance are well-designed, but we get back to knowledge and education and again. So the emphasis has to be to really put the focus on that issue so employees understand really economically what they are walking away from. So that is one thing.

In terms of opt-in versus opt-out, and so forth, inertia is an amazing, amazing power. If you are in——

Senator CARPER. I like that, I like that.

Mr. HENRIKSON. Yes.

Senator CARPER. Inertia is an amazing power. I am going to use that.

Mr. HENRIKSON. Well, it is because——

Senator CARPER. I will never say that you said it first. [Laughter.]

Mr. HENRIKSON. Well, we see it in the employee benefits field and in other areas continuously. It is not just on the 401(k) side; it is also in the group insurance side, and so forth, that whatever people initially sign up on, they tend to let that ride for the longest term, and I would say sometimes unfortunately even if it is not appropriate, because it is difficult to figure out share; what is more valuable to my family, and so forth.

So automatic opt-in, I think, is fantastic. It ought to be made simple to do from the employer's point of view, from a legislative point of view. But what we must also realize is that the indication

is, for example, on asset allocation that it is not unusual at all for an employee to set an asset allocation between fixed and equities, for example, in his 401(k) and then literally never change it. That is because there is a lack of continuing education at that particular plan or that particular employer. So that must be addressed.

I would say that kind of behavior is one of the reasons why we think people managing a bag of cash after they retire is particularly difficult because the facts tell us that employees—many of them are becoming comfortable with income averaging into the marketplace, comfortable because it is automatic, not because they think about it everyday.

When they retire, income averaging-out is not going to work very well if they are worried about invading principle. So the economists may say, “Well, then value-average out and you will be OK;” then you won’t invade that principle. So if the market goes down, just simply eat less this week, and I don’t think that works.

So we put all of this together when we think consumer behavior within the context of employee benefit plans is extremely important. That behavior is what is going to really determine what the success or failure of these plans are.

Senator CARPER. Mr. Chairman, my time is expired. Can I make one more point?

The CHAIRMAN. Yes.

Senator CARPER. My mom passed away last year after about a 5- or 6-year battle with Alzheimer’s disease, and I remember visiting her in a nursing home where she lived then those last few years in Ashland, KY. I was in a nursing home down in southern Delaware this past week and it just kind of reminded me of the years of people’s lives where they are unable to care for themselves, unable to work, in some cases not all that old. We spend a lot of money to sort of maintain them, to make sure that they are cared for either in our homes or in many cases in a facility like the one my mom stayed in.

As we think of ways to make sure that people don’t deplete whatever savings they have in the long run, part of it is actually curing a disease like that and to better ensure that when a person is like 80, 82, 85 or whatever, they can still fend for themselves, and in some cases maybe even, if they want to do something part-time, they actually do that. We actually have, believe it or not, people in the U.S. Senate at that age who actually come to work and get a paycheck.

My other point I wanted to raise is reverse mortgages. I don’t know that anybody has done that, but in my State we have always put a high emphasis on home ownership. Delaware has about a 75-percent home ownership rate, which is among the highest in the country, and we continue to push for that.

As you know, folks are able to, when they reach the latter stages of their lives and their homes are paid for, sort of live off of the equity of their home, which is an idea that has a great deal of attraction to me. I just would ask if you are aware of anything that we need to do with respect to home mortgages to make them more accessible. They are really not used that much. I am surprised how infrequently they actually are utilized.

But any thoughts that you have on how we might encourage people to make better use of the equity of their home—I think, as you know, for most people the biggest source of their savings in their lives is the equity in the home that they own.

Anybody at all? Yes, sir, Mr. Gilbertson, and then Mr. Stein.

Mr. GILBERTSON. I think one of the things that is happening as it relates to the very question you have is that we are talking about a reverse mortgage type of a situation where you can take some money out as you retire, and so on. But the waters haven't really been tested with those philosophies, and they can be very harmful if you are not very careful about the contract that you are entering into. So I think a lot of work needs to be done as it relates to that very issue.

You are correct that a majority of people are going to have their home paid for and they will have a tremendous asset there to draw upon that they will need. But, you know, we have to be very careful about how we put people into those types of situations because it can be very detrimental and harmful for them. So it is going to take a lot of study and a lot of work before we get comfortable with that concept, I think, but it is a goal that I think needs to be worked on.

Senator CARPER. Thank you.

Mr. Stein, and then Mr. Henrikson.

Mr. STEIN. Thank you, Senator. First of all, you do not need to give credit to my colleague to your left. Mr. Newton thought of the law of inertia, the body at rest——

Senator CARPER. I knew it was one of the two.

Mr. STEIN. Yes, he is a great genius of physics, but Newton did it a few centuries ago. A body at rest tends to remain at rest; in motion, tends to remain in motion.

Second, if I may respond to something else that you just said which I thought was a brilliant point that really we should have talked——

Senator CARPER. I said it?

Mr. STEIN. Yes. We should have talked about it before, which is if we imagine people——

Senator CARPER. That is a first. We should bring this man back more often.

Mr. STEIN. If we imagine people thinking about their own pool of assets, their bag of money, as the Chairman said, what if they do have Alzheimer's? What if they are mentally incapacitated? It is an awfully nice thing to have that regular check coming in in the form of the annuity to maintain their quality of life without them having to worry about having to make those decisions or be horn-swaggled or tricked by a number of unscrupulous people out there who will do that with people with Alzheimer's. It is a terrible thing, but it is true. So a steady source of annuity income is a lovely thing for people who are incapacitated in their brains or any other part of their body.

A third thing about reverse mortgages: as my colleague on my left said, the fees can be overwhelming; they can be startling. Also there is a tricky provision in there that if you leave your house for a certain amount of time, even if you go into a nursing home or for extended medical care, the person who had sold you the reverse

mortgage can sometimes seize your house. So there is a lot of strengthening of that particular kind of instrument that is needed.

Senator CARPER. Thanks. A quick true story. My mom used to live down in Florida, down in Clearwater, for a number of years after my dad died, and her mind was starting to slip a little bit. We kept her at home as long as we could and surrounded her with help around the clock, but she would get phone calls from these unscrupulous telemarketers to try to sell her this or that. I remember she put a roof on her house and the roof that she had was perfectly fine. I remember she spent more money buying a vacuum cleaner once than some people spend on a car.

But when we were packing her up to move her up to this nursing home in Kentucky, my sister found—as we were going through all this memorabilia, she found a long-term care insurance policy that somebody had sold to my mother for little, if any, money, and it was good for 2 years. For the first 2 years that my mom stayed in that wonderful facility in Ashland, it was largely paid for, and I thought my mom was smarter than all of us put together.

I think, Mr. Henrikson, you were going to say something. I am well over my time.

Mr. HENRIKSON. Yes, Senator Carper, a couple of things just to let you know how important MetLife feels about this topic of Alzheimer's. I don't know if you knew this, but the MetLife Alzheimer's award for research is the equivalent of the Academy Awards in that area. We have been focused on Alzheimer's as a societal problem for well over 20 years now.

I say also from a personal point of view my father was an Alzheimer's victim and I quickly would tell anyone so was my mother, because she actually passed away before he did and I am sure that had a lot to do with the stress and strain.

The other point you make in terms of as people age—and I think this is a very good one—we can all talk about being facile in terms of managing our portfolios while we are young, want to take the time to do it, educate ourselves, read the Wall Street Journal everyday, and so forth and so on. But as people age—and we find this not only in terms of our research with older people, and so forth—people even read print differently at a certain age based on the change in their eyes, and so forth. It is very important to be able to communicate with these people.

The checks we send via annuitization—someone mentioned spending, as you did, part of the time in one part of the country and part in the other. That is what we do. We track people down and we pay them their annuity payments, and we have schedules. Some of them stay in Florida these many months, in New York so many months, or whatever. It is very important to understand the dynamic of aging, the decisionmaking process and, quite frankly, the fear because one of the things that people really are burdened by is fear.

I know my parents became more and more fearful, and if they watched their bag of cash before they became more fearful, they watched it continuously. They didn't do anything with it. They didn't turn it into any income. They simply became fearful of the unknown because they didn't know how long it could last.

I think we are not here talking about wealthy people, but there are plenty of Americans who I think will be just imprisoned in their own homes through fear if they don't have an income to live on. It makes a huge difference in people's lives.

Senator CARPER. Thank you all.

Mr. Chairman, thanks for being so generous with this time. Thank you.

The CHAIRMAN. Gentlemen, we invited you all here recognizing your competence and the contribution you could make to this hearing. You have more than met our expectations and we are grateful to you. We want you to know that because of C-SPAN's good work, a lot of people will see you. It is amazing how many seniors in the country watch and care about what this Committee does. We care about their concerns and that is why we have had this hearing.

So in addition to Mr. Stein, you are all now TV celebrities and we congratulate you on that. But more, we thank you for your time. You have added immeasurably to the meaning of this day and to the Senate record.

With that, there are two roll call votes and we are adjourned.

[Whereupon, at 11:29 a.m., the Committee was adjourned.]

A P P E N D I X

PREPARED STATEMENT OF SENATOR RICK SANTORUM

Over the past year, the U.S. economy has created almost 1.9 million jobs; our unemployment rate fell to a remarkable 4.6 percent. Our productivity, real hourly compensation and personal income have all increased. Our nation's real GDP grew at an annual rate of 5.3 percent for the first quarter of this year, following a growth of 3.5 percent in 2005, the fastest rate of any major industrialized nation.

This incredible growth reflects the success of tax-relief legislation, Welfare Reform, and the elimination of the marriage penalty. Our recent doubling of the child tax credit and continued legislation that supports families and small businesses will continue to sustain these positive economic trends. It is clear that these programs from Congress have capitalized on the incredible resilience and creativity of the American people.

Yet, as more Americans gain jobs, as income increases, and as overall economic success indicators continue to stay strong, more and more Americans are feeling anxious about their financial futures. Leading economic indicators demonstrate that American households are not saving enough.

Over the past decade, the percentage of after-tax, disposable income saved has declined precipitously; the latest recorded personal-savings rate in the U.S. fell to an embarrassingly low negative 0.5%. This low savings rate lags far behind that of other industrial nations, constraining national economic growth and keeping many Americans from entering the economic mainstream.

In the face of uncertainty from outside retirement sources, financial security in retirement increasingly relies on the individual. Success and security today depend not just on a job and growing income, but increasingly on the ability to accumulate a wide range of assets. In the past, corporations and the government offered defined-benefit pension plans; Social Security was "more secure", and retiring seniors were certain that they wouldn't run out of money. The quickly shrinking number of defined benefit pension plans and the pending bankruptcy of the Social Security program all contribute to this increased financial uncertainty.

As other retirement programs become less reliable, owning a home, obtaining an education and building diverse financial investments are becoming key components to retirement for a growing number of Americans. These opportunities, however, are especially daunting for low- and moderate-income families. Asset-building strategies for these low- and moderate-income families, therefore, can no longer rest on government- and employer-provided programs; instead, financial security must include strengthening incentives to save and invest and also increasing financial education tools to enable individuals to make informed and appropriate decisions.

As a first-step to address the Social Security crisis, I introduced the Social Security Guarantee Act, which would ensure Americans born before 1950 that they would receive their Social Security check. This was my way to cut through the misleading rumors that reforming our Social Security program would leave America's seniors out in the cold. While I know that many of my colleagues want to have an open and honest debate over viable solutions for retirement security, fear and lies continued to shape the debate. It is my hope than in the near future we can acknowledge and address the unfair and financially unsound structure of our current Social Security system, and that the Social Security Guarantee Act will facilitate a more open and honest debate.

Reforming the structure of our current retirement program, however, is not enough to ensure financial security. In this difficult political environment, we must create asset-building programs and policies poised to boost savings in both the short term and the long term. One of the most promising strategies for achieving this, particularly among the low- and moderate-income working families who most need increased retirement security—is to facilitate the direct deposit of federal income tax deferrals into IRAs and other similar accounts. I commend the IRS's newly an-

nounced split-refund program, which will allow taxpayers to designate and deposit their refunds into a savings and retirement account with any U.S. financial institution.

Another important asset-building tool is the Individual Development Account. The Individual Development Account (IDA) program is an element in my Savings for Working Families Act that I introduced with Senator Lieberman. It encourages ownership among low-income individuals by offering them matches for their savings and by rewarding monthly savings of working-poor families who are trying to buy their first home, pay for post-secondary education, or start a small business. These matched savings accounts are similar to 401(k) plans, but better serve low-income families by providing them with financial literacy training and consultation. The Savings for Working Families Act will provide the infrastructure for sustained investment through combining IDAs with the educational tools that can ensure financial security.

My Savings for Personal Investment, Retirement, and Education Act includes another savings-promoting tool called a KIDS Account. KIDS Accounts will create an opportunity for every child and their family to begin investing in their future by providing a sound financial start for children born into poverty and creating opportunities for children and families to become more financially literate. The accounts will be supported by incentives designed to encourage savings, promote financial literacy, and expand asset-building opportunities like homeownership, education and retirement.

The final program that I'd like to mention is the 401(k) Enhancement Act, which provides incentives to employers to automatically enroll employers in 401(k) plans by removing the barriers that have deterred employers from offering automatic enrollment in the past. It is clear that automatic enrollment dramatically increases participation in 401(k) plans and boosts the savings rate. The Employee Benefits Research Institute reports that less than 40 percent of U.S. workers have calculated how much they will need to retire; 30 percent have not saved anything for retirement at all; and only 20 percent of Americans feel confident about having enough money to live comfortable in retirement. 401(k) plans are critical for financial security because they shift risk and decision-making from the growingly reluctant employers to the individual; the incentives included spur savings and employer-confidence within the programs.

It is my hope that Congress will support incentive-based savings programs to reflect the changing economic realities within America and then turn to seriously addressing the Social Security crisis. It is my belief that proactive public-private partnerships can expand opportunity for American families who fear their financial future. I believe that these incentives, coupled with educational programs and a fair and thorough look at our current pensions and Social Security policy will prevent the United States from encountering a savings and retired crisis.

Statement by Walter Welsh
Chairman of Americans for Secure Retirement

Senate Special Committee on Aging Hearing
"Managing Retirement Assets: Ensuring Seniors Don't Outlive Their Savings"
June 21, 2006

Mr. Chairman and distinguished members of the committee, on behalf of Americans for Secure Retirement (ASR), I welcome the opportunity to submit for the record our statement on policy recommendations to help Americans plan and save for their golden years.

ASR is a broad-based coalition of life insurance companies, industry groups, and non-profit organizations -- including women, farmers, Hispanic-American and small business groups -- committed to promoting policies that provide Americans with a more secure and stable retirement. We are pleased that this committee recognizes the importance of helping Americans effectively manage their assets throughout retirement to ensure that they do not outlive their savings.

This management side of the retirement policy equation has received relatively little attention, but it is an increasing concern for many Americans. In fact, a recent poll ASR commissioned found that half of American voters between 50-70 years old are actually more concerned about managing their savings so they do not outlive them, than actually just saving before retirement. These poll findings show that this hearing is both timely and of great interest to the 77 million baby boomers who will soon rely on America's retirement system.

There are a number of important factors contributing to the conundrum many face in planning for retirement, including increased longevity, a decreased ability to rely on regular monthly income from Social Security and pensions and, for many, no access or participation in any kind of employer-sponsored retirement plan. The question, then, for policymakers is how to encourage Americans to adequately save and manage those savings so they last for 20 to 30 years in retirement. For the reasons outlined below, ASR believes one important policy prescription is to promote individuals' "annuitization" of savings, specifically through lifetime annuities which would ensure a steady "paycheck for life."

All Americans at some risk

In policy circles, the notion of the "three legged stool" of retirement security is commonly used to illustrate the basic components necessary for maintaining a healthy living standard throughout retirement. The traditional means of financial security in retirement for Americans rested on Social Security, employer based retirement plans such as pensions, and personal savings. With the national savings rate at an all time low of negative 1.6%, and the other two legs less stable, that stool is now very wobbly.

For many of the upcoming baby boomer generation retirees, Social Security will be the main source of income in retirement. Unfortunately, while there is no denying the importance of this program, the fact is that on average, Social Security currently replaces only about 42 percent of pre-retirement income. And for those who retire before age 65 –which is more than 75 percent of retirees today- benefits are reduced

and Social Security replaces even less. Financial planners have traditionally recommended at least 70-80 percent to maintain a retiree's standard of living.

Similarly, the second leg of that stool – employer-based retirement programs – now supports less than half of all working Americans. Historically, many retirees have depended on pension plans to supplement their Social Security benefits. Participation in traditional defined benefit plans, which were a staple of retirement benefits in the past, has decreased sharply in recent years. The percentage of full-time employees in medium and large private establishments who are covered by defined benefit plans has fallen from 80 percent in 1985 to just 36 percent in 2000 as the trend shifts from offering defined benefit plans to defined contribution plans (e.g. 401(k) plans). Even taking into consideration 401(k)s, more than half of American workers -- around 88 million -- do not have access to or participate in any sort of employer based retirement plan. To put this in perspective, the number of Americans without employer-based plans is double the number of Americans without health insurance in the United States.

According to Dr. Jeffrey Brown, a former senior economist for the White House Council of Economic Advisers and author of The New Retirement Challenge, "these [pension plan] changes represent an historic shift in our retirement landscape, and together place more responsibility on individuals to manage their savings so that they last for a lifetime. It is important for us, as a nation, to find ways to encourage retirees to secure additional and reliable sources of lifelong income so that they can achieve lifelong financial security."

The shift in demographics in our country means that there is an even greater need for new policies that help Americans ensure a steady income throughout retirement. Today, the life expectancy of a 65-year-old is close to age 83, more than four years longer than in 1960. In fact, half of all retirees will live beyond average life expectancy. And, unprecedented numbers will be living into their 90s and past 100. The likelihood of living longer compounds both the savings and financial management challenge for individuals and families: retirees not only need to save more, they also need to manage these resources effectively so they provide a sufficient income to sustain a steady standard of living for 20 to 30 or more years.

Some Americans are more at risk than others

There are certain segments of the American population that face more difficult challenges in retirement. Women, minorities, small business owners, and farmers generally have less access to, and lower participation rates in employer-based retirement plans.

As this committee has observed, women live longer than men, spend more time in retirement and are widowed more frequently. A typical 65-year-old woman has a 31 percent chance of living to age 90 or older, as compared to only 18 percent for a typical 65-year-old male. Today, nearly 60 percent of older American women are single, with more than 45 percent widowed. Furthermore, many women work part time for all or part of their working years and therefore accrue less Social Security benefits, and fewer still participate in employer-provided retirement plans.

Minority groups, such as Hispanics, also face significant challenges. Hispanic-Americans have less workplace pension coverage than workers overall. Only 22 percent have

retirement savings plans to which their employers contribute money or stock, compared to nearly half of workers overall.

Farmers are in a similar situation. Compared with non-farm workers, farmers are less likely to participate in employer-sponsored retirement plans, further limiting their sources of retirement income. Just 30 percent of agricultural workers in America work for an employer with some form of retirement plan. Even more troubling is the fact that less than one quarter of agriculture workers participate in any retirement plan. That means the vast majority of farm workers have no other guaranteed sources of retirement income beyond Social Security.

Policy recommendations

A central challenge for policymakers is the need to make retirement options that provide steady, lifetime benefits more accessible to Americans. It is also important to ensure these opportunities reach the populations, particularly women, small business owners, farmers and minority groups, that have the least access to employer based retirement programs, or get the least from these and Social Security.

Since, aside from Social Security and pensions, lifetime annuities are the only retirement vehicles that provide a guaranteed stream of income throughout retirement, it is especially important for these segments of the population to be encouraged to "annuitize" some of their personal savings.

For these reasons, we support a tax incentive for Americans to use lifetime annuities. An annuity is a retirement planning vehicle that can provide lifetime payment at regular intervals. These lifetime payments begin when the retiree determines that the payments are needed and continue for the lifetime of the retiree and, if selected, his or her spouse. These lifetime payments serve as personal insurance that eliminates the risk of outliving one's assets.

ASR supports legislation introduced by Aging Committee Chairman Gordon Smith and Senator Kent Conrad called The Retirement Security for Life Act (S. 381, H.R 819) and The Flexible Retirement Security Act of 2005 (S. 1359), which encourages Americans to invest a portion of their savings in lifetime annuities to secure a guaranteed source of income in retirement. Under these proposals, individuals would not pay federal taxes on one-half of the income generated by lifetime annuities up to $20,000 per year. This would result in approximately $5,000 tax savings for a typical American in the 25 percent tax bracket.

These bills take a sensible approach to encouraging Americans to plan for the long-term. It should be among our top priorities to make sure that Americans are provided with the tools to help them adequately prepare for retirement and manage those savings so they last a lifetime. We are encouraged by this committee's demonstrated interest in addressing retirement challenges and look forward to helping you in these efforts. Thank you.

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U.S. Senate Special Committee on Aging Committee Hearing
"Managing Retirement Assets: Ensuring Seniors Don't Outlive Their Savings"

Pamela Schutz, President and CEO,
Retirement Income and Investments,
Genworth Financial

(Submitted June 21, 2006)

On behalf of Genworth Financial, I am pleased to submit this statement for the record. Genworth applauds the leadership of Chairman Smith and Ranking Member Kohl for their leadership on retirement issues and for calling this hearing to look at the critical questions of lifetime income and managing assets in retirement. With 15 million valued customers, operations in 24 countries, more than 5,000 skilled professionals, and more than $105 billion in assets (as of December 31, 2005), Genworth Financial, Inc. is one of the world's largest insurance organizations. We serve three major customer needs: lifestyle protection, retirement income and investments and mortgage insurance.

The Problem

Helping Americans improve their ability to enjoy a financially secure retirement is one of the most challenging domestic issues faced by Congress. Likewise, retirement is the most difficult financial planning exercise that the average individual will face in his or her lifetime because the stakes are so high - the potential consequence of making a mistake is to live the last years of one's life in poverty.

There are many issues that converge to create challenges for Americans as they plan to retire and live in retirement. Declining personal savings rates, the continued decline in availability of defined benefit pension plans, uncertainty of the amount of benefits that will be paid from Social Security and Medicare, the steady march of inflation – particularly in healthcare, and finally, the increasing longevity of American citizens. As the focus of this hearing is helping retirees create a "paycheck for life," it is important to recognize the degree to which the burden of assuring adequate retirement income has shifted to individuals, who typically have not been given the tools to meet this challenge. Importantly, at the center of the challenges and concerns individuals have about their retirement security is the lack of guarantees, in particular the lack of a guaranteed income that will last regardless of how long the individual lives and no matter how the stock market performs or the level of interest rates. There is widespread recognition that the purchase of life contingent, guaranteed income in the form of annuities prior to or at the point of retirement would help mitigate some of these risks, including:

- long-term rate of return risk (will your assets perform as expected),
- inflation risk (will your returns outpace inflation),
- excess withdrawal rate risk (how much can you safely withdraw),

- point-in-time risk (can you weather a down market at the time of retirement),
- longevity risk (will you outlive your assets), and
- health care risks (will your income stream support rising healthcare costs).

Potential Solutions

Life insurance companies are in a unique position to help employees manage retirement risks by partnering with defined contribution plan sponsors and mutual fund companies. Life insurance companies can pool longevity and investment risks across a large number of participants – thereby providing guarantees at the individual participant level. These guarantees are provided by financial institutions that are highly regulated by the states to assure that individuals receive the benefits they have been promised.

As a consequence, an emerging market is developing in what Genworth calls "Insured Defined Contribution" options. Insurance companies like Genworth are building new annuity products that allow sponsors to offer defined benefit type investment options to their employees within a 401(k) plan. The importance of an Insured DC option is that the individual throughout his or her working career, without having to wait until retirement, is able to determine with certainty how much guaranteed lifetime income his or her current 401(k) account balance will buy at a future retirement date.

The Importance of Life Annuities

One of the most important, and often least understood, sources of financial risk comes from uncertainty about how long one will live. According to a 2001 study by the Society of Actuaries, 67% of retired women and 55% of retired men underestimated the average life expectancy of a 65-year-old. This uncertainty means that there is a real risk of experiencing a reduction in living standard at older ages, even if one has tried to prepare for retirement. Saving is not enough; one must also be a careful manager of one's savings. Individuals should be encouraged to manage their savings during retirement in a manner that accommodates their daily needs, but also ensures that their savings will not be exhausted when they have more years to live. This is why life annuities are so important.

An annuity that continues to make payments for as long as you live (often called a life annuity) is an affordable, powerful retirement tool that allows individuals to manage many of their personal retirement risks. The life annuity is a combination of investment expertise and insurance that gives individuals the ability to insure against the financial risks of retirement by pooling their assets, and their financial risks, with a large number of other policyholders.

For many individuals, guaranteed lifetime income payments from an annuity may be the most effective way to ensure that retirement savings will not be depleted during their life. The key point is that life annuities, in whatever flavor may best suit a particular individual's circumstances, provide individuals with the guarantee of an income stream that will continue throughout their retirement years, no matter how long they live. By

using a life annuity the individual has the means of securing a larger retirement paycheck than had he or she pursued a systematic strategy of withdrawing their assets.

Thought Leadership

A key predicate to successfully managing the risks that Americans face in retirement is making sure that they understand those risks. Most Americans have not had the opportunity to prepare for the responsibility they will face at retirement. Financial planners report confusion about retirement planning and many working people do not understand how to convert assets into enough income to cover a lifetime of non-discretionary expenditures.

Against this backdrop, Genworth Financial recently hosted its 2nd Annual Retirement Income Symposium. The objective of the symposium was simple: To raise the awareness of retirement planning issues among senior executives within the financial services industry and to foster dialogue to identify opportunities for focus and collaboration to address some of these retirement-related issues. A number of distinguished academics and industry experts spoke at the symposium and the following is a brief summary of some of their key points.

Peter Walker, a Director with McKinsey & Company, shared findings from their just-completed Consumer Retirement Survey. For example:

- Consumer anxiety levels around the financial risks in retirement are rising rapidly
    - 61% of consumers are concerned about rising inflation or taxes – an 8 percentage point increase from 2004
    - 53% are concerned about insufficient guaranteed income – up 25 percentage points
    - 49% are concerned about rising health expenses – up 5 percentage points
    - 44% are concerned about cuts to Social Security benefits – up 29 percentage points
- 45% of Boomers expect to work beyond 65, but only 13% of retirees have actually done so
    - The average expected retirement age is 67
    - The average actual retirement age is 59

  This is a critical finding since it represents an average of eight fewer years to earn and save income prior to retirement
- 40% of retirees were forced to stop work earlier than planned, due largely to health issues, job displacement or caring for a spouse or family member

Mr. Walker's data shows that for many Americans, their quality of life in retirement may not be as good as they would like it to be.

Cindy Hounsell, President of WISER (Women's Institute for a Secure Retirement), emphasized the unique challenges that women face in retirement. Women, particularly in retirement, will tend to live longer than men, are more likely to be single, have less income and assets than men, are less likely to receive employer benefits, and are more likely to live below the poverty line. She offered the following statistics:

- Nearly 2/3 of working women earn less than $30,000 per year
- In 2004, the median retirement income was $12,080 for women and $21,102 for men
- For 1 in 4 older women, Social Security is the only source of income
- Women retirees receive only half the average pension benefits that men receive

As Ms. Hounsell quoted Bette Davis, "Old age is no place for sissies", her point was clear: living comfortably in retirement can be particularly challenging for women. Ms. Hounsell pointed out numerous actions that women, employers and policy makers can take to improve the prospects for women in retirement including education, saving more earlier, creating default options within employer plans to ensure reasonable levels of saving and benefits, providing credits for years devoted to care giving and expanding and simplifying the Saver's Tax Credit.

Dr. Jeffrey Brown, Associate Professor of Finance at the University of Illinois, spoke to the value of guaranteed income annuities and the power of annuitization. Dr. Brown demonstrated that individuals can consistently receive a higher amount of income from a lifetime payout annuity than from any other strategy including withdrawal plans and "self annuitization". This is because payout annuities provide a "mortality premium", which offers a higher rate of return while living in exchange for giving up the right to the wealth upon death. Dr. Brown also addressed the concept of the "probability of ruin", which is the probability of running out of money. Only annuities can guarantee the maximum sustainable amount of lifetime income. All other non-annuitized assets run the risk of depletion if withdrawal rates are too high or market returns too low.

Independent research that Genworth Financial commissioned with Ibbotson Associates and distributed at the Retirement Income Symposium quantifies the probability of ruin an individual assumes from different investment strategies. The Ibbotson Associates Study of Insured Defined Contribution Retirement Income Strategies (May 2006) quantifies the probability of ruin for three investment strategies: a Balanced Fund, a Lifecycle Fund, and an Insured Defined Contribution (IDC) option based on the ClearCourse^{SM} Group Variable Annuity (a 401(k) investment option that distinguishes itself by offering plan participants, regardless of age, guaranteed income for life with upside potential). In brief, both the Balanced and Lifecycle funds show significant probabilities of ruin as the investor ages. Whereas, the IDC has a zero probability of ruin since the option contains a guaranteed payout annuity for life.

Conclusion

The challenge of preparing for retirement is growing. Multiple forces are impacting the ability of many Americans to live comfortably in retirement. There is no one perfect solution. Through the collaborative efforts of policy makers, the private sector, consumers and regulators, solutions can be found. We applaud Chairman Smith for his leadership in advancing legislation (S. 381, S. 1359) that supports tax incentives for qualified and nonqualified annuity streams. In addition, pension reform legislation, currently in Conference, includes important tools for managing retirement savings, such as auto enrollment incentives in 401(k) plans, tax code modifications to allow consumers

the flexibility to combine qualified long-term care policies with annuities and life insurance products, and maintenance of today's contribution limits for retirement savings plans.

Creating these solutions is dependent on open, constructive dialogue and a willingness to employ innovative ways to solve the growing retirement income crisis in America. Hearings such as this one are essential to fostering the dialogue and sparking our collective creative spirits. Genworth Financial is committed to being a leader in helping people succeed financially in a world of shifting burdens. We are honored to participate in this discourse and look forward to discussing the many different alternatives available to resolve some of these critical retirement savings and income issues faced by our country.

Genworth
Financial

NEWS RELEASE

6620 West Broad Street
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Annuitization of Retirement Savings Key
To Ensuring Financially Secure Retirement

Genworth Applauds Senate Aging Committee
For Focus on Making Savings Last

WASHINGTON (June 21, 2006) -- Genworth Financial, Inc. (NYSE: GNW) today applauded the Senate Special Committee on Aging for focusing on the need to help ensure seniors don't outlive their savings and called on Congress to enact legislation promoting the "annuitization" of retirement savings as a way to secure a regular income stream throughout old age.

"Recent studies showing dwindling participation in pension plans and personal savings rates in the negative numbers underscore the importance of promoting policies to help Americans not only save, but also better manage their finances throughout retirement," said Pamela Schutz, President and CEO, Retirement Income and Investments, Genworth Financial. "I congratulate Chairman Smith and Ranking Member Kohl for holding this important hearing and specifically the Chairman for his leadership in Congress to enact policies that promote "annuitization" of retirement savings so individuals can count on a steady form of income to last as long as they live."

"Annuitization" is a concept that is winning support in Congress and refers to the vesting of a portion of assets into a retirement planning vehicle that can provide lifetime payment at regular intervals, effectively providing "insurance" against outliving one's savings. By pooling longevity and investment risks across a large number of participants, life insurance companies guarantee the income promised to their policyholders.

"The retirement picture is not what it was when our parents were planning for their golden years and the burden of planning has clearly shifted to the individual. That's why Genworth

is innovating new and creative ways to help Americans convert some of their savings into a steady paycheck for life," Schultz said. "Whether through new products guaranteeing 401(k) investments or the more traditional lifetime payout vehicles, annuities offer a reliability and durability that is a crucial component of retirement planning."

Multiple forces are impacting the ability of many Americans to live comfortably in retirement. There is no one perfect solution. Genworth applauds Chairman Smith for his leadership in advancing legislation (S. 381, S. 1359) that supports tax incentives for qualified and nonqualified annuity streams. In addition, pension reform legislation currently being negotiated in Conference between the House of Representatives and the U.S. Senate, includes important tools for managing retirement savings, such as auto enrollment incentives in 401(k) plans, tax code modifications to allow consumers the flexibility to combine qualified long term care insurance policies with annuities and life insurance products, and maintenance of today's contribution limits for retirement savings plans.

About Genworth Financial

Genworth is a leading insurance holding company, serving the lifestyle protection, retirement income, investment and mortgage insurance needs of more than 15 million customers, and has operations in 24 countries, including the United States, Australia, Canada, Japan, Mexico, New Zealand, the United Kingdom and 17 other European countries. For more information, visit www.genworth.com.

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Retirement Income

June 9, 2006

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Managing savings – pre-retirement

Investors mis-manage their savings leading up to retirement

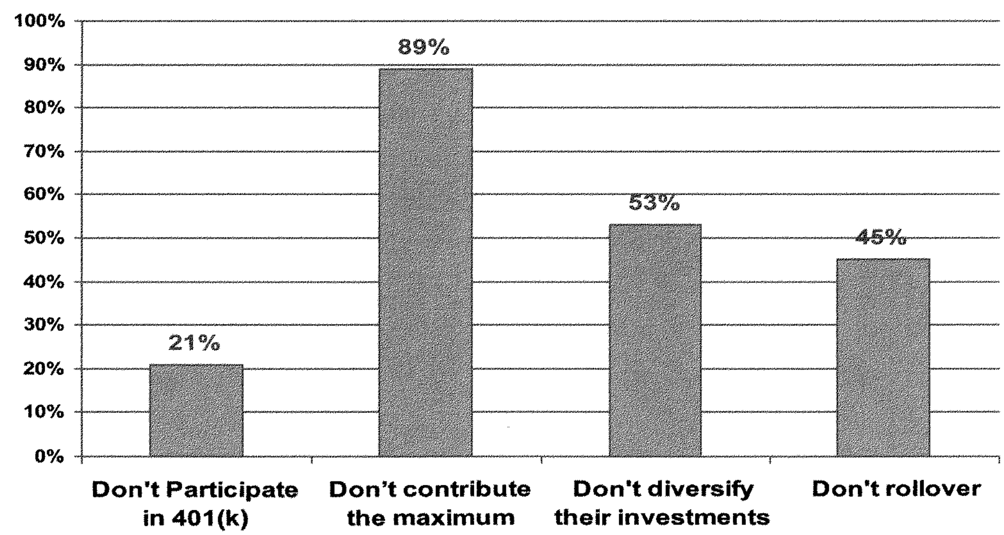
- Do not take advantage of retirement accounts like 401k plans[1]
- Do not follow concepts of Modern Portfolio Theory such as proper diversification
- Take lump sum distributions when changing employers (don't rollover savings).[2]

[1] Source: Alicia H Munnell and Annika Sunden 2006 "401(k) plans are Still Coming Up Short." Issue Brief No. 44 Chestnut Hill, MA Center for Retirement Research at Boston College and authors' calculations of the *Survey of Consumer Finances.*

[2] Source: Calculations based on 2004 Survey of Consumer Finances and Sarah Holden and Jack VanDerhei. 2005 "401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2004. Issue Brief 285. Washington, DC: Employee Benefit Research Institute.

Accumulations fall short because people make mistakes at each stage

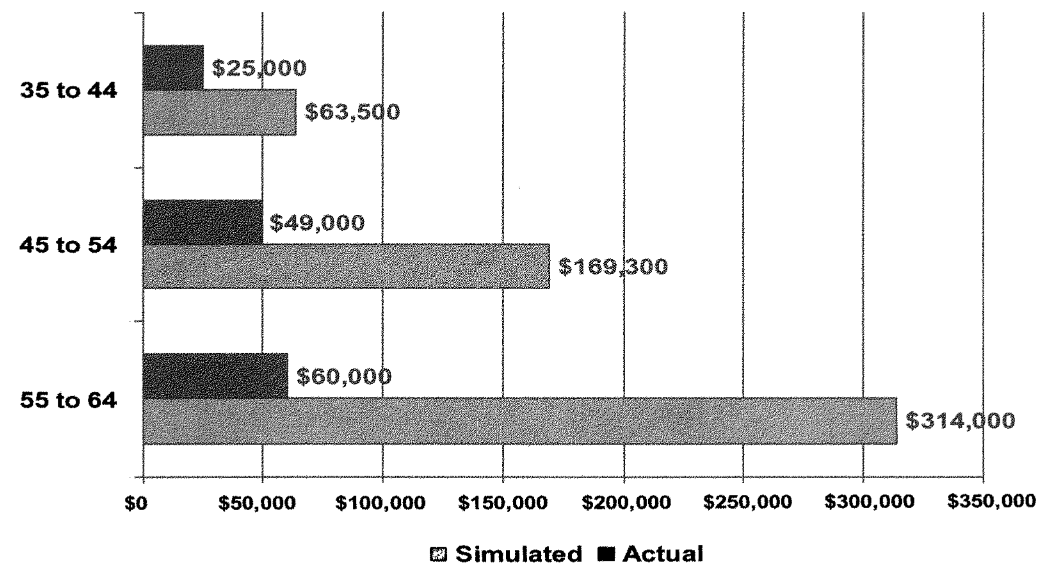
Percent of Individuals, 2004



Source: Calculations based on 2004 Survey of Consumer Finances and Sarah Holden and Jack VanDerhei. 2005 "401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2004. Issue Brief 285. Washington, DC: Employee Benefit Research Institute.

In theory, 401(k) plans could work well, but in practice they do not.

401(k)/IRA Actual and Simulated Accumulations, by Age Group, 2004



Source: Alicia H Munnell and Annika Sunden 2006 "401(k) plans are Still Coming Up Short." Issue Brief No. 44 Chestnut Hill, MA Center for Retirement Research at Boston College and authors' calculations of the *Survey of Consumer Finances*.

Managing savings – in retirement

- Money is managed in retirement the same way it is managed during accumulation
- This process doesn't account for different types of objectives and risks retirees face when "deaccumulating" their assets
  - Time frame
  - Goals
  - Different risk measures

Source: Fullmer, Richard (2005) *Funding Life after Work: Retirement Income Strategies.* December 2005 Knowledge Capital Web Cast, Russell Fund Distributors, Inc.

Managing savings – in retirement

- Retirees do not follow Modern Portfolio Theory concepts in retirement[1]
  - Worries about running out of money ironically cause seniors to invest conservatively
    - They ignore the risk premium on equities
- Some seniors feel the need to make up for lost time and invest too aggressively[1]
- Consumers do not understand the impact of inflation[2]

[1] Dolan, Farrell and Harlow, Van (2003) *Lifetime Income Planning*, Viewpoint: Retirement Issues Consumer Research Report, Fidelity Investments

[2] Greenwald, Mat (2004) *Report on phase two focus Groups*, VARDS Greenwald Strategy Service.

Managing savings – in retirement

- Only 1 in 5 retirees or pre-retirees has any formal written retirement income plan[1]
- Existing plans based on poor assumptions
  - Short-term approach to planning
  - Use average return assumptions
  - Underestimate life expectancy
  - Base plans on length of time money is likely to last
  - Do not allocate assets aggressively enough
  - Fail to account for longevity risk
  - Taking withdrawals that are too aggressive

Sources: Greenwald, Mat (2004) *Report on phase two focus Groups*, VARDS Greenwald Strategy Service. Greenwald, Mat (2005) *Report on final phase of 2005 focus group and in-depth interview research on life annuities*, VARDS Greenwald Strategy Service.

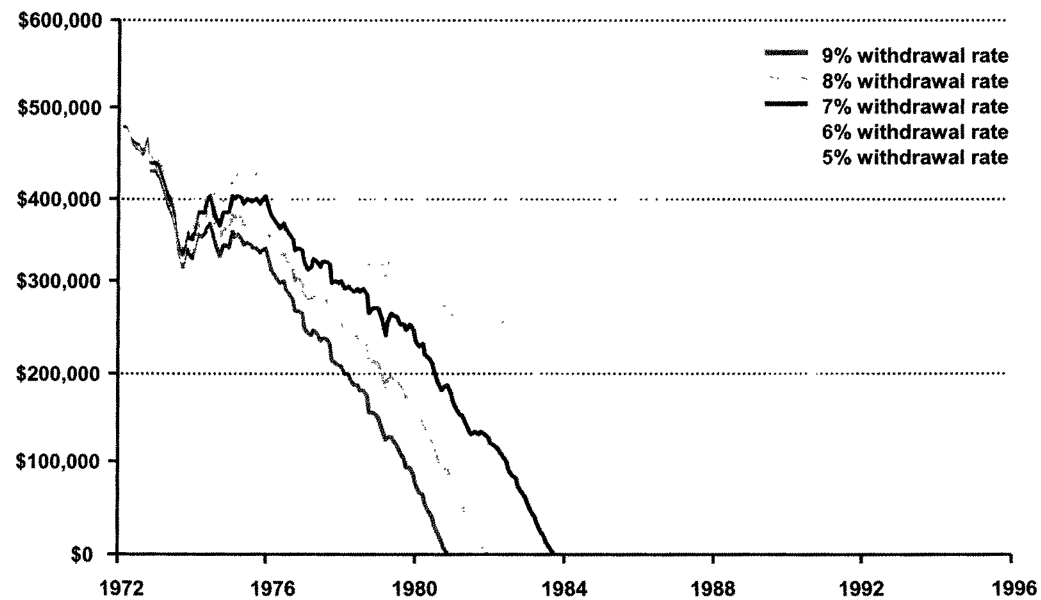
Inflation Adjusted Failure Rates 1946-1999

Initial Withdrawal Rates	75%/25% Stocks/Bonds	50%/50% Stocks/Bonds	25%/75% Stocks/Bonds
7%	68%	88%	100%
6%	56%	68%	100%
5%	32%	36%	92%
4%	8%	16%	40%
3%	0%	0%	0%

Initial withdrawal rate adjusted each year for inflation/deflation. Portfolio Failure Rate: Percentage of all past payout periods from 1946 to 1999 that are NOT supported by the portfolio after adjusting withdrawals for inflation and deflation. Note: Numbers in the table are rounded to the nearest whole percentage. The number of overlapping 30-year periods from 1946-1999 is 25. Stocks are represented by the Standard and Poor's 500 Index, bonds are represented by long-term, high-grade corporates and inflation (deflation) rates are based on the CPI. Data Source: Calculations based on data from Ibbotson Associates. Source: Retirement Planning Journal published in 2001.

Potential shortfall: The risk of high withdrawal rates

Annual inflation-adjusted withdrawal as a % of initial portfolio wealth



Hypothetical value of $500,000 invested at year-end 1972. Portfolio: 50% large company stocks/50% intermediate-term bonds. Assumes reinvestment of income and no transaction costs or taxes. This index performance does not reflect the different fees and charges associated with variable annuities. If it did, the performance would be lower than cited above.

Source: *Ibbotson Presentation Materials*, ©2006 Ibbotson Associates, Inc. All rights reserved. Used with permission.
This is for illustrative purposes only and not indicative of any investment. Past performance is no guarantee of future results. 3/1/2006.

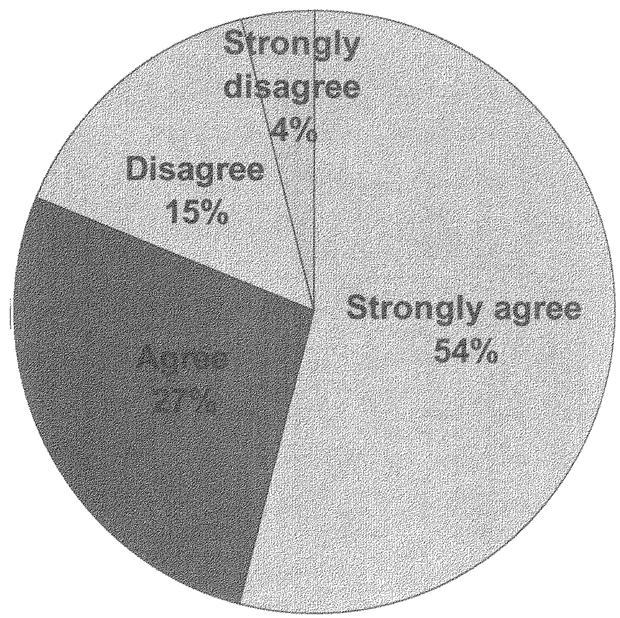
Managing savings – in retirement

Advisors not doing a particularly good job of helping retirees plan

- Advisors do not use any type of simulation tool in retirement income planning
- Few advisors sell or recommend annuities which could deal with longevity risk
- Many advisors do not pay attention to longevity risk and do not have effective approaches to educate their clients about it

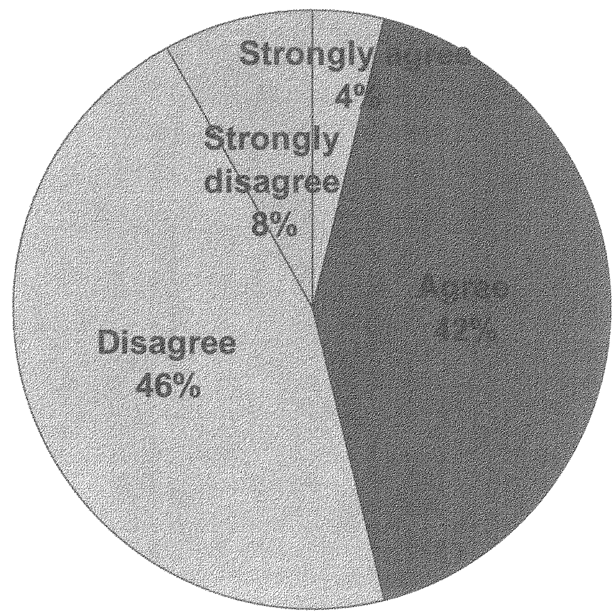
Sources: Greenwald, Mat (2004) *Report on phase two focus Groups*, VARDS Greenwald Strategy Service. Greenwald, Mat (2005) *Report on final phase of 2005 focus group and in-depth interview research on life annuities*, VARDS Greenwald Strategy Service.

Distribution of Accumulated Assets Integral to Growth Strategy



Source: LIMRA ***Research Briefings*** - Retirement Distribution Sales Force Training, Issue Number 8 published September 2005

Producers Are Well Trained to Advise Clients on Retirement Distribution



Source: LIMRA ***Research Briefings*** - Retirement Distribution Sales Force Training, Issue Number 8 published September 2005

Possible Solutions

- Educate workers and provide incentives for the broader use of 401(k)s and other retirement vehicles
  - Default sign up
  - Automatic set-up
  - Lifestyle funds – easier allocation/diversification
  - Provide options for what to do at retirement
- Provide education, tools, and resources to retirees on retirement risks and how to address those risks
- Educate retirees on the benefits of having a written, long-term plan
- Build/provide simulation tools to help retirees build plans
- Encourage use of products to address risk-based needs
  - Annuities to address longevity risk
  - Life Insurance for estates or survivor income
  - Long-term Care

Northwestern Mutual approaches

- Provide training and education to Financial Representatives on the role that Annuity products play in structuring retirement Income
  - i.e. Addressing longevity risk
- Work with Financial Representatives on how to address the risk-based needs faced by retirees in retirement
  - Positioning Insurance products alongside investment products to meet needs

American Council of Life Insurers (ACLI) Statement for the Record

"Managing Assets in Retirement"

Senate Special Committee on Aging

United States Congress

June 21, 2006

101 CONSTITUTION AVENUE, NW, Suite 700, WASHINGTON, DC 20001-2133
Telephone: (202) 624-2000 Facsimile: (202) 624-2319

The American Council of Life Insurers (ACLI) commends this Committee for calling a hearing which focuses on the issues related to managing assets in retirement – the other half of the retirement security puzzle – and for its important work this year in focusing national attention on retirement security issues. We have previously submitted a statement for the record of the Committee's March 15th hearing on "Women and Retirement Security," and are pleased to submit this statement for today's hearing on "Managing Assets in Retirement." We applaud Chairman Smith (R-OR) and Ranking Member Kohl (D-WI) for drawing attention to these vital matters and hope our suggestions will contribute to meaningful deliberations about solutions to the imminent retirement security crises.

The ACLI is a Washington, DC – based trade association whose 377 member companies account for 91 percent of the life insurance industry's total assets in the United States, 90 percent of life insurance premiums and 96 percent of annuity considerations. In addition to life insurance and annuities, ACLI member companies offer pensions, including 401(k)s, long-term care insurance, disability income insurance and other retirement and financial protection products, as well as reinsurance. Life insurers are among the country's leaders in providing retirement security – both on savings accumulation and distribution -- to Americans.

Three-legged Stool of Retirement Security

This is not your grandfather's retirement. Retirees in the last half of the 20th century were, for the most part, able to rely on the three legs of the retirement security stool – Social Security, employer-provided pensions, and personal savings – to provide income during their retirement years. For the next generation of retirees, however, the three-legged stool is wobbly. With the level of future Social Security benefit in doubt, the uncertain fate of employer-provided defined benefit plans, and the historically low rates of personal savings, we are facing a real retirement security crises.

Even for those with a relatively certain pension and personal savings, the three-legged stool for many will not support what may become the heaviest burden in retirement – the cost of long-term care and health-related costs. The paradigm for retirement planning has already begun to shift to take account of these facts.

For the coming wave of Baby Boom retirees, and those generations following, receiving retirement income will be less about guaranteed monthly benefits from a pension plan or Social

Security. It will be more about managing risk in order to manage assets in retirement. While there are several kinds of risk that will challenge retirees, longevity risk and long-term care-related risk are among the most disconcerting, and deserve to be the focus of intense public policy attention.

Longevity Risk

The risk of outliving one's accumulated retirement savings, has become increasingly relevant for two reasons. Starting in the 1980s, the employer-sponsored plan world shifted from traditional defined benefit plans – which traditionally paid retirees a lifetime annuity -- to defined contribution plans, which generally can be withdrawn as a lump sum distribution. According to the Department of Labor, the total number of defined contribution plans more than doubled from 1980 to 1999, growing from 340,805 to 683,100. During the same time, the total number of defined benefit plans has fallen from 148,096 to 49,895.[1] Additionally, half of all workers are not covered by an workplace plan.

At the same time, Americans are also living longer. Actuarial predictions estimate that one-fifth of today's 35-year-olds who reach retirement age can expect to live into their 90s. With increasing life expectancies, come longer retirements. Combining the longer time in retirement with the need for retirement income and the increased availability of lump-sums from employer-sponsored plans, has lead to concerns about retirees outliving their assets. This "longevity risk" has been identified by 49 percent of current workers as their primary retirement concern, according to a 2004 survey by MetLife.

The shift away from defined benefit plans at the same time people are living longer has resulted in increased risks being placed on individuals. Retirees taking a lump sum distribution from their workplace retirement plan will have to manage not only the risks associated with outliving their retirement savings, but risks associated with market fluctuations over a longer period of time. Data suggests these risks are real, and may be, colliding. For instance, according to a January 2005 report by the Employee Benefits Research Institute (EBRI), about 15 percent of those age 64 to 74 lost more than half of their total wealth from 1992 to 2002, and about 30 percent had lost more than half of their

[1] Private Pension Plan Bulletin, Abstract of 1999 Form 5500 Annual Reports, U.S. Department of Labor, Number 12, Summer 2004, Tables E2, E3.

financial wealth due to post-retirement investment losses.[2] As a result, there is less money available to last over a lengthening, yet uncertain, lifespan.

Annuitization Insures Against Longevity Risk

The ACLI strongly believes that one way to mitigate the risks associated with longevity is to encourage plan sponsorship and to encourage plan sponsors to voluntarily offer immediate, lifetime annuities as an optional form of distribution from the plan. Unlike defined benefit plans, defined contribution plans are not required to offer an annuity as an optional form of benefit. Indeed, the number of large employers offering an annuity payout option to 401(k) participants fell from 31% to 17% between 1999 and 2003, according to a survey by Hewitt Associates,[3] and lump sum distributions from defined contributions account for nearly 95 percent of all distributions. While some of those lump sum amounts are rolled into other retirement savings vehicles, very little of the money is put into a distribution product that will guarantee a retirement stream of income.

In order to enhance individual's retirement security, Congress must make it a top priority to adopt incentives that will result in higher levels of annuitization for all workers.

Congress should remove the artificial barriers that deter of plan sponsors from offering annuities as an optional form of distribution. According to sponsors, one such barrier is the ambiguous Department of Labor guidance as to how to select an annuity provider. We very much appreciate the work Chairman Smith and Senator Conrad did on this issue, including language in their bill S.1359, the Retirement Savings and Security Act, that would have clarified a fiduciary's obligations when benefits from a defined contribution plan are paid as an annuity. The work done in preparing S.1359 laid the groundwork Congress to address this issue by providing a clarification to the "safest available annuity" standard in the pension bills currently in conference. We urge you to encourage the conferees to adopt this provision and pass a favorable report.

[2] Craig Copeland, "Changes in Wealth for Americans Reaching or Just Past Normal Retirement Age," Employee Benefit Research Institute, Issue Brief No. 277, January 2005.
[3] Pamela Perun, "Putting Annuities Back into Savings Plans," Society of Actuaries, 2004, <http://library.soa.org/library-pdf/m-rs04-2_11.pdf>.

Another barrier that exists arises from the burdens of the spousal consent rules that apply under ERISA and the Code, which provide that benefits to married participants must be paid in the form of a qualified joint and survivor annuity (QJSA), unless the participant and his or her spouse consent to another form of distribution. The spousal consent and waiver rules require, among other things, that participants execute and submit to the plan hard-copy (i.e. non-electronic) notarized forms. The processing of these paper forms is generally regarded as burdensome, costly, and difficult to administer, and has resulted in fewer annuities being offered by defined contribution plans.

The ACLI has actively sought to address this issue through regulations from the Department of Treasury and Internal Revenue Service. We commend the Department on its publication of proposed regulations last year on electronic plan administration, which for the first time acknowledged that spousal consents may be performed electronically. These proposed regulations have not been finalized, and we encourage this Committee to urge the Department to finalize them with a rule permitting electronic spousal consents.

We understand that Chairman Smith and Senator Conrad are preparing new legislation focused on women and retirement security which may include a provision which would require further study of spousal consent rules in defined contribution plans. We commend the Chairman and Senator Conrad for their interest in seeking to address this important issue.

More importantly, Congress should also provide tax incentives to encourage all individuals – which include those covered by a workplace plan as well as those who are not -- to convert some of their savings into guaranteed lifetime income. Chairman Smith and Senator Conrad have taken an important leadership role in the Senate in encouraging individuals to annuitize their savings by including in S. 1359 provisions that create a tax incentive for the purchase of a lifetime annuity. ACLI was among the first trade associations to endorse the legislation when introduced, and remain actively supportive of its provisions. We urge other Senators to endorse this critical legislation.

Lastly, for those who don't elect to purchase an immediate annuity, Congress can help facilitate the purchase of longevity insurance. This type of insurance allows workers to convert a portion of their savings to pay benefits upon reaching very old age. Congress can facilitate the purchase of this annuity product by excluding the value of the insurance from minimum required distribution calculations.

Insurers, of course, have a part to play as well in promoting annuitization. There is more the industry can do to educate policymakers, employers, and consumers about the benefits of lifetime annuities and on some of the product innovations that are making annuities more attractive to today's retirees. Traditional annuity contracts were often seen as a "bet with an insurance company." A person dying prior to his or her life expectancy would "lose the bet." No more. Today's annuities are more flexible than traditional annuity contracts. Insurers have responded to the needs of retirees by including new features in annuities, such as: return of premium guarantees which permit more options when it comes to retirement planning; guaranteed income products allow individuals to benefit from a rising stock market, while providing insurance against market downturns; and products that allow individuals to periodically buy a piece of a stream of lifetime income.

Perhaps the single most important thing policymakers can do is to create a legal framework and regulatory environment conducive to continued product availability and innovation.

Long-Term Care Risks

As people age, and for a longer period of time, there will inevitably be an increased demand to shift long-term care risk. ACLI's recently-updated study on long-term care and the "Baby Boom" generation notes that about 55 percent of those 85 and older require some form of long-term care, and about 19 percent of all seniors suffer from some degree of chronic impairment. By 2050, it is estimated that up to 5.4 million seniors will need the services of a nursing home – the most costly form of long-term care – and another 2.4 million will require home health care.

The cost of long-term care is high and increasing, averaging $70,912 annually for a private room or $62,532 annually for a semi-private room in a nursing home; $25.32 per hour for a visit by a home health aide; and an average annual *base* rate of $32,294 for the services of an assisted living facility. Since 1990, the price of nursing home care has increased at an average annual rate of 5.8 percent – almost double the overall inflation rate.

Total annual expenditure on long-term care for the elderly is estimated to be $135 billion, which accounts for over 9.7 percent of total spending on health care for persons of *all* ages. This is roughly 1.2 percent of the U.S. GDP. Of greater significance is that the elderly account for a disproportionately large percentage of total health care expenditures -- 36.3 percent of expenditures -- while accounting for only 12.4 percent of the population. Because baby boomers are aging and the cost of care is increasing, total

spending on nursing home care is expected to more than triple over the next 25 years and to increase more than five-fold in the next 45 years. These increases will place a crushing burden on Medicaid and ultimately on taxpayers, most of whom are working-age adults. Currently, there are about five working-age adults per senior, but by 2030, there will only be 2.9 – a 40 percent decline. This decline will occur while both the need for and cost of long-term care increase.

Insure Against Long-term Care Risk

Long-term care insurance offers critical protection against the risk of depleting savings to pay for needed care and becoming a financial burden. It is a crucial component of retirement planning. It protects retirement savings from being depleted by the steadily growing costs of long-term care, and provides consumers with the dignity of choice by covering a wide range of services in a variety of settings. With the increasing cost of care, total spending on nursing home care is expected to more than triple over the next 25 years and to increase more than five-fold in the next 45 years. These increases will place heavy burdens on government programs, and ultimately on taxpayers.

Long-term care is available on an individual basis, or through a group plan sponsored by an employer or association. An increasing number of group employers – including the federal government and more than 20 state governments – recognize the importance of long-term care insurance in retirement planning and offer it as part of their employee-benefit packages.

There are a number of ways Congress can encourage individuals to shift the risk of paying for long-term care. First, by encouraging the creation of hybrid products that assumes a number of risks, Congress can help individuals meet a wide array of financial needs. Congress has already taken an important step to encourage such product innovation. There is a provision contained in the House version of the pension bill now in conference which would amend the tax code to permit companies to offer policies that combine the features of an annuity with the benefits of long-term care insurance. Removing that impediment would likely result in increased utilization of long-term care insurance. This proposal would create more flexibility and choice for American consumers. During working years, individuals could accumulate assets in an annuity; at retirement, depending on the needs of the individual, that annuity could be used to provide lifetime income. A long-term care insurance benefit within the annuity would pay for long-term care services.

Another provision would also clarify the tax treatment of the combination of long-term care insurance and life insurance. For the long-term care/life insurance combination, the life insurance would serve its critical function of death protection, while also being available to provide funds for payment of long-term care costs. Again, we urge you to encourage the conferees to adopt these provisions and pass a favorable report.

Additionally, Congress should also provide an "above-the-line" deduction for individuals who purchase long-term care insurance. Lastly, Congress should remove the tax barrier which prevents long-term care insurance to be part of an employer's cafeteria plan or allows workers to use their flexible spending account monies to pay the premium on long-term care insurance policies.

Conclusion

Again, we commend Sen. Smith and Sen. Kohl on their bi-partisan approach to studying these important issues. We appreciate the opportunity to present our views for the record, and look forward to working with you and your staffs on these issues in the future.

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